Scottish Widows Limited

Annual Report and Accounts
2020

Member of Lloyds Banking Group

CONTENTS **PAGE(S)**

COMPANY INFORMATION

Board of Directors

N E T Prettejohn (Chair)

J R A Bond
W L D Chalmers
K Cheetham
J E M Curtis
J C S Hillman*
J F Hylands
A Lorenzo*
C J G Moulder
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G E Schumacher

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J M Jolly

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GROUP STRATEGIC REPORT

The Directors present their strategic report on Scottish Widows Limited ('the Company') and its subsidiary undertakings (together referred to as 'the Group') for the year ended 31 December 2020. The Company is limited by share capital.

The Group contributes to the results of the Insurance and Wealth Division of Lloyds Banking Group. Scottish Widows was founded in 1815, and since then we have been focused on helping customers protect themselves today whilst preparing for a secure financial future. Our objective is to be the best insurance and retirement savings business for customers; providing simple, trusted, value for money products accessible through our customers' preferred channels.

As we look to the future, we see the external environment evolving rapidly. The rapid pace of technological change, new regulation and increased competition are driving significant changes in customer needs and expectations. As a customer-driven business, we see these as opportunities. Our strategic plan responds to all of these challenges and transforms the Group for success in a digital world.

We have identified the following strategic priorities for the Insurance and Wealth Division of Lloyds Banking Group, focused on the financial needs and behaviours of the customer of the future, and the Division's progress against those priorities are:

Delivering a leading customer experience

- Achieved 5 stars for the fifth consecutive year in the Financial Adviser Service Awards in Investments, and Pensions and Protection, together with the Editor's Achievement Award for 30 years' Consistent Service
- Being the first major pensions and insurance provider to target halving the carbon footprint of its investments by 2030 on its path to net zero by 2050
- Commenced £2 billion investment in BlackRock's Climate Transition fund which delivers around 50 per cent carbon reduction compared to benchmark; helping customers save for retirement, whilst investing in sustainable businesses
- Announced commitment to divest at least £440 million from companies that do not meet our ESG standards
- Achieved Group Strategic Review target of 15 per cent market share of Workplace business, up from 10 per cent at start of 2018

Digitising the Group

- Launched the Scottish Widows app in the fourth quarter to approximately 500,000 customers. Customers are able to engage with their retirement planning, representing a key strengthening of our proposition
- Single Customer View expanded to include stockbroking portfolios with 6.5 million customers able to access their Insurance and Wealth products alongside their bank account (up from over 5 million at the end of 2019)

Maximising the Group's capabilities

- Grew open book assets under administration by £46 billion, or 68 per cent, over the two-year period to 31 December 2020 to £113 billion, narrowly missing the Group Strategic Review £50 billion growth target despite challenging market conditions
- Further exceeded Group Strategic Review target set in January 2018 of 1 million new pension customers, with 1.5 million now added
- Completed migration to Schroders Personal Wealth. Continue to strive to become a top 3 financial planning business

Our strategy will enable us to transform ourselves into a **digitised**, **simple**, **low risk**, **customer focused**, UK financial services provider.

Our strong foundations, differentiated business model and our great, highly engaged team will enable sustainable success in a digital world and ensure we continue to help Britain prosper.

Our Insurance Strategy will create a scalable and efficient business and deliver value for money propositions for our customers that are aligned to clear and growing customer needs.

Principal activities

The principal activity of the Group is the undertaking of ordinary long-term insurance and savings business and associated investment activities in the United Kingdom. The Group also has freedom of services overseas through branches, which administer a relatively small amount of business, principally in Germany. This business is administered through a subsidiary, Scottish Widows Europe S.A. (SWE). The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the Lloyds Banking Group network and direct sales. The Group also reinsures business with insurance entities external to the Group and Lloyds Banking Group.

GROUP STRATEGIC REPORT (continued)

Result for the Year

The result for the year ended 31 December 2020 is a Group loss after tax £(196) million (2019 loss: £(21) million). The result is reflective of market conditions during the year following Covid-19 impacts, but also reflects the effect of assumption changes, principally expense assumptions.

The United Kingdom leaving the European Union

The UK / European Union (EU) Trade and Cooperation Agreement (TCA) means a disorderly Brexit has been avoided. While the TCA contains limited, high-level provisions on financial services, further detail is expected to emerge during this year, and the Group will continue to monitor developments closely. Activity to respond to potential risks include the transfer of business to a European subsidiary in 2019 to ensure continuation of certain business activities, customer communications, market volatility scenario exercises, contingency planning and monitoring of emerging European Economic Area (EEA) regulatory requirements.

Covid-19

Our business has primarily a UK focus and the outbreak of Covid-19, in line with its global impact, is expected to continue to adversely impact the UK economy as well as causing volatility in global financial markets. As the situation continues to evolve, so does our assessment of the risks and the degree to which they might crystallise. The Company's resilience to such events is regularly reviewed through stress and scenario testing; plans to continue to operate critical business processes are in place and are being reviewed in light of the Covid-19 outbreak. Note 37 provides further details of the impact on market risk (note 37 (c) (1)), insurance underwriting risk (note 37 (c) (2)), credit risk (note 37 (c) (3)) and capital risk (note 37 (c) (4)).

Climate Change

<u>Strategy</u>

Lloyds Banking Group's unique position within the UK economy means that the successful transition to a more sustainable, low carbon economy is of strategic importance to us. Lloyds Banking Group supports the aims of the 2015 Paris Agreement, the UK government's Net Zero target and Ten Point Plan for a Green Industrial Revolution; and the recommendations of the Taskforce on Climate-Related Financial Disclosures (TCFD).

Our ambition

Lloyds Banking Group has set seven leadership ambitions to support the UK's transition to a sustainable future, those that directly apply to the Group are:

- *Pensions and investments*: Be a leading UK pension provider that offers our customers and colleagues sustainable investment choices, and challenges the companies we invest in to behave more sustainably and responsibly
- *Our own footprint*: Be part of a leading UK bank in reducing our own carbon footprint and challenging our suppliers to ensure our own consumption of resources, goods and services is sustainable

The Group has announced a target of reaching net zero carbon emissions across our investment book by 2050, with an intermediate target of halving our investments' relative carbon footprint by 2030. We cannot rely on mass carbon offsetting schemes; instead we have committed to driving carbon reduction in the real economy to achieve net zero goals. We intend to reach the target through proactive investment in climate solutions, selective divestments and using our influence through stewardship to drive the transition to a low carbon future, following the Institutional Investors Group on Climate Change (IIGCC)'s Net Zero Investment Framework.

Pensions and Investments

The Group has focused on building robust foundations for future Responsible Investment (RI) activity, launching our Responsible Investment Framework in March 2020 and developing Stewardship and Exclusions Policies. These have a consistent central objective: using our scale to offer our customers sustainable investment opportunities and to challenge the companies the Group invests in to become the sustainable businesses of the future. Scottish Widows' RI Framework, Stewardship Policy, and Exclusions Policy are available to view online via https://www.scottishwidows.co.uk/about_us/responsibleinvestment/.

The Group has established a Responsible Investment team which is made up of professionals with diverse backgrounds in RI, policy, research, advocacy, data, and climate science. The team is set to continue to grow in line with our developing ambitions.

As an asset owner, the Group works with the largest of our investee companies to engender positive change and enhance their approach to climate and Board diversity issues. The Group delegates broader engagement activity to our investment managers, who the Group oversees to ensure they live up to their promises. Where we have found their demonstrated activity has not fulfilled the promises made to the market, we have escalated and followed up on its resolution. The Group asks all of our fund managers to comply with the UK Stewardship Code or an equivalent for their jurisdiction.

GROUP STRATEGIC REPORT (continued)

Climate Change (continued)

Strategy (continued)

Pensions and Investments (continued)

In 2020, we continued our direct engagement with key investees in the energy sector. We engaged with them to discuss their plans to evolve their businesses into green energy production and increase transparency in the way they manage climate change risk, in order to seek to reduce the risk of our investments in these companies becoming ‘stranded assets’, a key way in which sustainability risk becomes investment risk.

The Group looks after the retirement savings of millions of hard-working people and our role is to help them plan for their long-term financial prosperity. To do this, it's important the Group continues to use our scale and influence, along with our fund manager relationships, to challenge the companies the Group invests in on our customers' behalf to be the sustainable businesses of the future. The Group aims to address material financial risks and seek opportunities linked to Environmental, Social and Governance (ESG) factors in the investments that Group makes, and this is the foundation of our Responsible Investment Framework.

The Group is also investing £2 billion of our Pension and Retirement Portfolio Pension Funds capital into a new fund, the ACS Climate Transition World Equity Fund, co-created with BlackRock that looks to increase investment in companies that are well prepared for the low carbon transition and to reduce exposure to those that are less so.

The Group’s Exclusions Policy focusses on companies that have failed to meet our ESG standards, namely manufacturers of controversial weapons, UN Global Compact violators and those deriving more than 10 per cent of their revenue from thermal coal and tar sands extraction. The Group is currently divesting an initial £440 million from these companies, starting with those investments where the Group has direct control and are working to expand the application of this policy into external pooled funds that underpin our multi-asset funds. Early success of our engagement with one of our partner asset managers has led the investment manager to introduce an exclusions policy for all their Europe-domiciled passive funds totalling over £20 billion, leading to an additional divestment of approximately £280 million within our customer pension portfolios.

Through our shareholder Investment activity the Group provides direct loans for renewable energy, including for offshore wind and solar energy.

Initiatives and collaboration

The Group recognises they can be most effective through collaboration and we continue to work with other external bodies, organisations and initiatives pursuing responsible investment and climate-related policy or advocacy initiatives:

- IIGCC, where the Group took a leading role in the development of the Net Zero Investment Framework
- Principles for Responsible Investment (PRI)

Governance

Given the strategic importance of the Group’s sustainability ambitions and commitment to managing the impacts arising from climate change, our governance structure is evolving to provide clear oversight and ownership of the management of climate-related risk.

In 2020 the Group reviewed and updated the Terms Of Reference of relevant Insurance committees to include the requirement for the committees to consider Climate Risk.

Executive oversight is provided by a Responsible Investment Committee. This committee, with strong Board support, plays a pivotal role in setting the Group’s sustainability agenda and provides strategic direction to our Responsible Investment activity.

Risk Management

Lloyds Banking Group adopted a comprehensive approach to embedding climate-related risks into their Enterprise Risk Management Framework through:

- Creation of a new primary risk for climate risk, in order to drive dedicated focus and a consistent approach, while enhancing Board-level insight
- Integration of climate risk into all existing primary risks, to ensure comprehensive consideration across all aspects of business activity, including the Group’s activity

As the understanding and importance of climate risk progresses, climate scenario analysis is becoming an essential capability and risk management tool. Scenario analysis assists the identification, measurement and ongoing assessment of climate risks over the longer-term. In 2020, Lloyds Banking Group has developed their climate scenario analysis framework and will see outputs from this in 2021.

GROUP STRATEGIC REPORT (continued)

Climate Change (continued)

Risk Management (continued)

Lloyds Banking Group has engaged with third-party consultants to support the development of our climate risk management framework, extending our modelling and assessment capabilities for quantifying climate risk.

Lloyds Banking Group has external sector statements that help articulate appropriate areas of climate related risk appetite and approach to the risk assessment of our customers. The Group's asset managers are required to follow the Scottish Widows Stewardship Policy and Exclusions Policy. These statements and policies are consistent with the overall ambition, which is to align lending and investments with a fair and orderly transition to a sustainable and low-carbon economy, thus reducing our exposure to ESG-related and climate-related risks.

Climate Metrics

Emissions of investments

Together with Lloyds Banking Group, the Group believes it is appropriate to provide more financial information on financed emissions recognising this is a rapidly developing area with evolving and sometimes limited data availability, data completeness and calculation methodologies.

Lloyds Banking Group expects these areas to continue to improve in 2021 and beyond, helping it to refine its approaches, estimates and understanding of the climate risk within Lloyds Banking Group's portfolios, including within the Group. However, in order to enhance disclosure, whilst recognising these limitations, we detail our estimated view of the 2018 financed emissions for the Group's Policyholder assets in the table below.

2018 Estimated Financed Emissions

	Total Assets Under Management (AUM), £	AUM in-scope according to PCAF methodology, £	In-scope AUM for which emission data is available, %	Estimated total MtCO2e (Scope 1 & 2 emissions, for investments where data is available)	Emissions per £1m invested (where data is available)
Scottish Widows Assets[1]	120 billion	111 billion	70 per cent	14.2 MtCO2e	168 tCO_2e / £million invested

Note: [1]Includes unitised and with-profit fund assets held within the Life and Pension funds of Scottish Widows Limited and mutual funds managed by the LBG Authorised Corporate Directors Scottish Widows Unit Trust Managers Limited and HBOS Investment Fund Managers Limited and excludes Scottish Widows Administration Services Limited (SWAS) assets under administration.

We are disclosing 2018 emissions as there was more comprehensive company emissions reporting data available at the time of calculation. We have used the emerging industry standard for calculating financed emissions developed by the Partnership for Carbon Accounting Financials (PCAF) and using the S&P TruCost carbon dataset as a key input. The current figures include financed emissions from listed equities, corporate bonds and cash. Given this is a new discipline which will continue to develop and evolve, it is expected that these numbers may change in the future and may require restatement as methodologies for calculating financed emissions mature, and data availability and quality improves.

As currently recommended by PCAF, the financed emissions estimate only includes Scope 1 and 2 emissions of investments. Off balance sheet contingents or areas where there is no methodology, such as derivatives and government bonds, are not included. Cash is included based on a zero commission, in line with the PCAF methodology.

Policyholder and shareholder investments are governed by the Responsible Investment and Stewardship Framework, Stewardship Policy and Exclusions Policy, while direct lending part of Shareholder investments is also covered by Lloyds Banking Group External Sector Statements. The Group will be further developing our approach to reporting appropriate climate metrics and targets for both policyholder and shareholder customer investments and will set a baseline for the recently announced Net Zero strategy.

For pension customers, the Group is investigating responsible investment metrics, such as carbon intensity and how to share this with our customers. This area is moving quickly and the Group expects much to become visible in 2021. This will evolve in the short-term, as consensus on the best communication methods to our clients and customers across the industry matures.

Further details of the Lloyds Banking Group approach of transitioning to a low carbon economy and our operational impact can be found in the Lloyds Banking Group Annual Report and Accounts and ESG report, which can be downloaded via www.lloydsbankinggroup.com.

GROUP STRATEGIC REPORT (continued)

Key performance indicators

Funds under management

Funds under management relating to policyholder liabilities were £160.0 billion (2019: £153.7 billion). The movement reflects net flows from policyholders and investment returns for the period.

Solvency II

Our business model has exposure to a portfolio of risk types with the aim of maximising the capital benefit of risk diversification allowed under Solvency II. An Internal Model is used to calculate the Solvency Capital Requirement (SCR) taking account of the specific risks to which the Company is exposed. A Matching Adjustment is assessed, resulting in a beneficial impact on the level of regulatory capital held in relation to annuities business.

During the year, the Group has delivered Solvency II reporting including full annual quantitative reporting as at 31 December 2019, as well as the narrative reporting required by Solvency II. The Company has a waiver from the PRA exempting it from preparing a solo Solvency and Financial Condition Report (SFCR) for each Insurance entity. Instead, in May 2020, the Company reported publicly through a Group SFCR for Scottish Widows Group Limited. The next SFCR will be published in April 2021.

The Directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future. On a Solvency II basis the estimated regulatory surplus of the Company in excess of capital requirements is £2.2 billion (2019: £2.6 billion post dividends). The payment of a dividend is not planned in the first quarter of 2021.

The Solvency II ratio for the Insurance Group[1] of 152 per cent (pre dividend equivalent ratio for 2019: 170 per cent) represents the shareholder view of Solvency II surplus[2]. The equivalent ratio for SWL is 149 per cent while the Regulatory Solvency Ratio[3] to be included in the SFCR is estimated to be 142 per cent.

During 2020, benefits arose from capital generation on existing business, partially offset by capital invested in new business. However significant adverse market volatility and credit downgrades resulting from the Covid-19 pandemic have driven a lower regulatory surplus and solvency ratio. In addition, the Company paid dividends of £560 million in February 2020 (2019: £300 million in February 2019). Further information on the capital position of the Company is given in note 37.

As agreed with the Prudential Regulation Authority (PRA), the wider Insurance and Wealth Division submitted a single Own Risk and Solvency Assessment (ORSA) for 2019 covering the Group headed by Scottish Widows Group Limited, and the assessment of own risks and solvency needs of the Company is therefore covered by that assessment. The ORSA report for 2020 was submitted to the PRA in March 2021.

Generation of capital surplus

Expected earnings on in-force business generated significant surplus capital in 2020, through both generation of Own Funds and run-off of the SCR. This was used in part to fund investment in new business and to cover debt costs.

Market variances, primarily due to falls in interest rates and credit asset downgrades, resulted in a reduction in Solvency Surplus through both a reduction in Eligible Own Funds and an increase in the Solvency Capital Requirement.

The material miscellaneous items comprise a number of items including run-off of the beneficial impact of the Solvency II Transitional Measures for Technical Provisions (which smooth the impact of moving from Solvency I to Solvency II).

As Eligible Own Funds at 31 December 2019 anticipated the dividend of £560 million and no ordinary dividend is planned in relation to 2020 performance in the first quarter of 2021, the payment of the dividend has had no net impact to Eligible Own Funds (this is expressed in the table as a negative non-operating charge).

[1] The Solvency II pre year-end dividend ratio is calculated as the ratio of eligible own funds divided by the SCR. The own funds in this ratio exclude allowance for any year-end foreseeable dividend that may be payable in the February following the year end.

[2] The shareholder view of Solvency II excludes the impact of with-profits business on eligible own funds and SCR.

[3] The Regulatory Solvency Ratio includes allowance for the impact of with-profits business.

GROUP STRATEGIC REPORT (continued)

Generation of capital surplus (continued)

		Eligible Own Funds £m	SCR £m	Solvency Surplus £m
As at 31 December 2019		**7,724**	**5,162**	**2,562**
Regulatory and other model changes		72	25	47
Operating impacts:	New business contribution	47	165	(118)
	Expected in-force contribution	369	(264)	633
	Assumption changes and experience variances	(185)	(154)	(31)
	Debt costs	(79)		(79)
Market variances		(159)	359	(518)
Material miscellaneous items		(355)	(67)	(288)
Other non-operating charges		560		560
Capital management (payment of dividends and repayment of subordinated debt capital)		(560)		(560)
As at 31 December 2020		**7,434**	**5,226**	**2,208**

Comparison of Group total equity to Solvency II own funds

Group Total Equity is as shown on the Balance Sheet on page 32.

	31 December 2020 £m	31 December 2019 £m
Group total equity per the Balance Sheet	**2,336**	**3,084**
Adjustment for subsidiaries not included in Solvency II own funds	73	72
Company total equity per the Balance Sheet	**2,409**	**3,156**
Valuation differences to Solvency II		
Intangible assets not valued in Solvency II (see note a)	(1,676)	(1,676)
Replace insurance and participating investment contract liabilities and non-participating investment contract liabilities with Solvency II best estimate liabilities (see note b):	6,430	6,804
Revalue investment in subsidiaries for Solvency II (see note c)	(91)	(80)
Subordinated debt contributing to capital under Solvency II (see note d)	155	115
Deferred tax (see note e)	(483)	(427)
Other	(1)	(11)
Solvency II excess of assets over liabilities	**6,743**	**7,881**
Movements from assets over liabilities to own funds (see note f)	691	(157)
Regulatory eligible own funds	**7,434**	**7,724**

Notes:

a. Intangible assets are not recognised under Solvency II

b. The difference between Solvency II Best Estimate Liabilities and IFRS Liabilities (in respect of Insurance, participating investment and non-participating investment contracts).

c. The difference between Solvency II and IFRS valuation of subsidiaries. Under Solvency II, subsidiaries are recognised at their underlying balance sheet value, while under IFRS, some subsidiaries are recognised at cost

d. The difference within the Solvency II and IFRS valuation of subordinated debt

e. Deferred tax timing differences in relation to the valuation differences set out above

f. Subordinated debt less ring-fenced assets which cannot be used to cover capital requirements

GROUP STRATEGIC REPORT (continued)

The following table sets out the quality of eligible own funds of the Company

No new Subordinated Debt (Tier 2) Capital has been issued by the Company over 2020, so the reduction in Own Funds over 2020 has been covered by Equity (Tier 1 unrestricted) Capital. The Company holds material investments in liquid assets, which could, if necessary, be realised within three months. The amount of liquid assets held is greater than the Own Funds in excess of capital requirements (£2.2 billion).

Regulatory Eligible Own Funds	31 December 2020 £m	31 December 2019 £m
Tier 1 unrestricted	5,667	6,020
Tier 2	1,767	1,704
Total	**7,434**	**7,724**

Liquidity

The Company regularly monitors its liquidity position to ensure that, even under stressed conditions, the Company has sufficient liquidity to meet its obligations and remain within the approved risk appetite. As at 31 December 2020, the Company had liquidity coverage of 132 per cent (2019: 143 per cent). Liquidity coverage is defined as the comparison of available liquid assets, net of known cash flows, against 1-in-200 scenario stressed cash flows and 1-in-200 scenario liquidity risks. Liquidity methodology and reporting is compliant with Solvency II.

During 2020 there have been offsetting impacts within the SWL excess liquidity position, with an overall reduction in liquidity coverage since 31 December 2019.

Market movements during 2020 led to an increase in liquidity mainly due to an increase in the market value of fixed income assets. This was more than offset by an increase in stressed adjustments.

Stressed requirements increased during the year due to the purchase of new assets in the annuity fund, a modification to the level at which collateral agreements were netted and an increase to the impact of currency stresses on certain non-UK assets.

Present value of new business premiums (PVNBP)

Life and pensions sales (PVNBP) for the year were £14,529 million (2019: £17,515 million). PVNBP decreased 17 percent mainly driven by the reduced market activity due to the Covid-19 pandemic, reduced volumes in bulk annuities and the non-recurring 2019 benefit from auto-enrolment step-ups.

Non-financial KPIs

The Directors consider non-financial KPIs in respect of the Group’s strategic priorities. Where relevant, non-financial KPIs are presented below against the strategic priorities presented in this report.

	2020	2019	2018
Customer satisfaction (Net Promoter Score - Life, Pensions and Investments business) (Strategic priority: Delivering a leading customer experience)	41	43	39
Customer complaints (FCA reportable complaints per 1,000 policies - scores align to latest SWL Company biannual returns) (Strategic priority: Delivering a leading customer experience)	1.21	0.97	0.85
Colleague engagement index (% favourable - represents Insurance and Wealth Division index excluding Wealth index) (Strategic priority: Maximising the Group's capabilities)	75	69	70

Other Sources where KPIs are presented

The Group also forms part of Lloyds Banking Group’s Insurance and Wealth Division. The development, performance and position of the Insurance and Wealth Division are presented within Lloyds Banking Group’s Annual Report, which does not form part of this report.

The Directors consider that the above are the key performance indicators which are appropriate to the principal activity of the Group. These, together with other metrics which cover customer, operational measures and capital, are included in the balanced scorecard which is used to measure all aspects of the performance of the business. In addition, the Directors are of the opinion that the information contained in the Company's Solvency II reporting on capital resources and requirements and regular actuarial reports, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Company and the Group.

GROUP STRATEGIC REPORT (continued)

Review of the business

In addition to the progress made against the strategic initiatives summarised earlier there are other areas that are worthy of note and these are described below. Decisions taken in the areas described below and in pursuit of our strategy are brought to the Board for due consideration and approval.

Outsourcing of long-standing customer administration platform

The outsourcing contract with Diligenta was signed on 19 September 2017. The service improvement activity under the contract has delivered the one life and pensions system data migration events which were scheduled in 2020 to plan, as well as other activities to prepare for in-house ledger changes. Further life and pension system data migrations are planned through to 2022.

Bulk Annuities

We have continued to support corporate customers in de-risking their balance sheets, with the successful completion of a further four (2019: five) bulk annuity transactions, bringing in £1.0 billion (2019: £2.0 billion) of liabilities from third-party pension schemes.

Outlook

The Directors consider that the Group's principal activities will continue to be unchanged in the foreseeable future.

Principal risks and uncertainties

Details of key risks are set out in note 37. Key risks include economic and political uncertainty alongside operational risk which is heightened by the current level of change being undertaken to execute our strategy. Risks and uncertainties to our strategic plan, both positive and negative, are considered by product through the planning process. The following table describes the key risks faced by the Group. Further details on these risks and how the Group mitigates them can be found in note 37, as shown by the note reference.

Key Risk	Note reference	Description
Market risk	37(c)(1)	Market risk is the risk that the Group's capital or earnings profile is affected by adverse market rates. Of particular importance to the Group are equity, credit default spreads, interest rates and inflation for assets backing insurance business.
Insurance underwriting risk	37(c)(2)	Risks are transferred from policyholders to the Group through writing insurance business. These include mortality risk, morbidity risk and persistency risk.
Credit risk	37(c)(3)	Credit risk is the risk that parties with whom we have contracted, fail to meet their financial obligations. The Group is subject to credit risk through a variety of counterparties through invested assets which are primarily used to back annuity business, cash in liquidity funds and bank accounts, derivatives and reinsurance.
Capital risk	37(c)(4)	Capital risk is the risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group. Capital, which includes regulatory capital for the Company and regulated subsidiaries, comprises all components of equity and subordinated debt. In addition to ensuring that the Company maintains sufficient regulatory capital to meet Solvency II capital requirements (based on a one in 200 year event), the Group's capital management strategy, as part of the integrated insurance business (see note 37(c)(4)) requires it to hold capital in line with the stated risk appetite for the business, which is to be able to withstand a one in ten year stress event without breaching the capital requirements.
Liquidity risk	37(c)(5)	Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. The Group is exposed to liquidity risk from payments to policyholders and non- policyholder related activity, such as investment purchases and the payment of shareholder expenses).
Operational risk	37(d)	Operational risk is the risk of loss from inadequate or failed internal processes, people and systems or from external events.
Economic risk and UK political uncertainties	37(e), 37(f)	The Group faces economic and political uncertainty arising from the impact of Covid-19, as well as the need to continue monitoring developments following the adoption of the UK / EU TCA.

In addition, as described in note 28, during the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings (including class or Group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the United Kingdom and overseas.

GROUP STRATEGIC REPORT (continued)

Principal risks and uncertainties (continued)

All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to properly assess the situation, and no provisions are held in relation to such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

Section 172(1) Statement and Statement of Engagement with Other Stakeholders

The Board is collectively responsible for the long-term success of the Group. Understanding the interests of key stakeholders (this includes customers, shareholders, communities and environment, regulators and suppliers), is central to the Group's strategy, crucial to the Group's success, and informs key aspects of Board decision-making as set out in this Statement.

Stakeholder engagement is embedded in all aspects of the Board's decision-making and can be seen in the range of tailored activities across key stakeholder groups. It is also embedded in the Board's delegation of the management of the Group's business to the Chief Executive Scottish Widows and Group Director Insurance and Wealth, with examples of related actions taken included within the Report.

Management provide the Board with details of material stakeholder interaction and feedback, through regular business updates. Stakeholder interests are also identified by management in the wider proposals put to the Board.

During 2020, interaction with stakeholders was adapted in response to the government's provisions on Covid-19 and has been undertaken virtually as necessary.

This section (pages 12 to 15) acts as our Section 172(1) Statement, however given the importance of stakeholder interests, these are discussed where relevant throughout the Report.

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the Directors provide this Statement describing the ways in which they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Group under section 172. Further details on key actions in this regard are also contained within the Directors' Report on page 16 and the Corporate Governance Report on page 17.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), this Statement also provides examples of how the Directors have engaged with and had regard to the interest of key stakeholders. The Group is a subsidiary of Lloyds Banking Group, and as such follows many of the processes and practices of Lloyds Banking Group, which are further referred to in this statement where relevant.

Customers

The Board's understanding of customer's needs is vital in setting and achieving the Group's goals. Customer needs and a customer-centric approach remain therefore a key consideration in Board decisions.

Covid-19 Response

The Group's response to the Covid-19 pandemic has been a central focus for the Board since the start of the outbreak. The Board has sought to take all possible steps to support customers through these challenging times. Board reporting from management included enhanced monitoring of customer service performance, emerging market and economic impacts, which informed the Group's approach in response to the crisis. Covid-19 Risk Surgeries were established in March 2020 to rapidly assess proposals for customer and business process change. Additional meetings of the Board were convened early in the pandemic to oversee the Group's operations as customer servicing transitioned to the remote operating model that was needed to meet UK government expectations and to keep colleagues safe. The Board held colleague engagement sessions during 2020 which considered, among other things, changes made to support customers through the Covid-19 pandemic. Alongside operational matters, the Board considered emerging impacts to customers from markets and the economic environment including changes in customer behaviour as a result of Covid-19 impacts. The Board considered and discussed the Customer Treatment response to Covid-19, to include providing support to Vulnerable Customers. Outwith its formal meetings the Board also received executive briefings in respect of these matters at a heightened frequency during the first wave of the Covid-19 pandemic.

GROUP STRATEGIC REPORT (continued)

Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

Customer Trust

Customer trust is always a priority for the Board. The Board ensures that the Group as part of Lloyds Banking Group works toward achieving its customer ambitions, to treat all customers fairly, and makes it easy for customers to find, understand and access products that are right for them. Regular reporting from management allows the Board to monitor performance. The Board's Risk Oversight Committee (ROC) reviews customer-related risk matters and scrutinises risk performance data (including Complaints and Conduct Risk Appetite Metrics) to identify areas where improvements can be made. Every opportunity is taken by the Board to consider customer feedback and related management information, including as part of the Directors' strategic decision-making process. A key priority for the Board in its early response to the Covid-19 crisis was the oversight of management actions taken to protect critical customer processes and stabilise the Group's operations.

The Board periodically reviews the performance of its customer brands and, during 2020, reviewed in detail the Scottish Widows brand and the ongoing relevance of the "Widow" as a brand icon, particularly among younger audience groups and in response to society's changing gender ethics, concluding that the brand remained relevant among all customer groups.

Delivering Value for Customers

The Board routinely reviews the performance of its customer propositions at its meetings and discusses matters particular to each within a cycle of in-depth reviews. During 2020 the Board reviewed the effectiveness of the various channels open to customers to do business with the Group, customer investment fund choices and their performance, alongside the impacts of the Covid-19 pandemic on the UK economy and how the Group's propositions might adapt to support customers as a result.

The Board gave detailed consideration during 2020 to the Value Assessments undertaken by the Authorised Corporate Director (ACD) business. As a result, several changes are being implemented to simplify the pricing structures across funds. Charges paid by many customers are reducing. Work underway will enable greater alignment and consistency between charges and the investment style of funds.

The Group has engaged proactively with its regulator to drive forward good business conduct in its core markets. The Group has also given consideration to vulnerability characteristics in customers and how these should be identified and support given to customers.

Group and Fund Performance

The Group's business model of outsourcing fund management means asset managers who specialise in specific areas of the market are selected to deliver the investment performance expected by customers. This approach also allows the Group to keep the performance of its appointed asset manager under constant review. The transfer of the management of most of the Group's active funds to Schroder Investment Management Limited provides access to leading investment management expertise and will help to drive improved potential for increased investment returns for customers. The Board of the Group invited representatives of Schroder Investment Management Limited to one of its meetings in 2020 and discussed with them fund performance, current market views and their views on environmental, social and governance investment.

The Board of the Group recognises the importance of understanding its performance in supporting customers, including how the Group performs in this regard relative to its peers. Regular Board updates from management cover a range of relevant internal and external sources. Together these provide important insight that informs Board decision-making.

Technology Transformation

The Board has taken steps to make sure the Group continues to build on its responses to customer demand for technology. Whilst Digital transformation has remained a key focus in improving the customer experience, the Board acknowledges that many customers still value being able to get in touch with customer service staff over the phone, via letter or through email. The importance of the Group continuing to offer and improve these services in parallel is recognised by the Board. As part of the Group's drive towards continuously improving the service provided to customers, the appointment of Diligenta, a leading provider of business process services will, over time, offer customers new ways of transacting and managing their products online, allowing them to access the information they need quickly and easily. The Board of the Group has a rolling programme of discussions with executive leaders on technological matters and took part in virtual demonstrations for forthcoming technological initiatives during 2020 including the Scottish Widows App.

Helping Britain Recover and Society of the Future

The Board ensures it continues to participate and play an appropriate role in all Lloyds Banking Group related initiatives. The needs of customers as the Covid-19 pandemic abates has been a focus of Lloyds Banking Group and underpins the development of its Helping Britain Recover Plan, building on its Helping Britain Prosper ambitions. The development of Lloyds Banking Group's Society of the Future initiative aims to make sure its purpose remains aligned to a changing society and including the changing expectations of all its customers. Further information on these initiatives can be found in the Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2020, available on the Lloyds Banking Group website.

GROUP STRATEGIC REPORT (continued)

Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

Shareholders

The Group is a wholly owned subsidiary of Lloyds Banking Group, forming part of its Insurance and Wealth Division. As a wholly owned subsidiary the Board ensures that the strategy, priorities, processes and practices of the Group are aligned where appropriate to those of Lloyds Banking Group, ensuring that its interests as the Group's shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group with its shareholders is included within the Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2020, available on the Lloyds Banking Group website.

Two senior leaders of Lloyds Banking Group serve as Directors on the Group's Board and the Chair of the Group's Board serves also on the Board of Lloyds Banking Group. The Group's Board arranged for a special briefing from the Lloyds Banking Group Chief Executive early on in the Covid-19 pandemic to discuss the Group's response to government advice and initiatives to support customers and colleagues. The Group's Board also met with the Board of Lloyds Banking Group on one occasion during 2020 for a discussion of business strategy including digital interconnectivity between the Insurance franchise and its parent.

During 2020, in order to further improve its understanding of external perceptions of the Group, the Board welcomed investment banking experts to share their perceptions of the Group with the Board.

Communities and the Environment

The Group is part of Lloyds Banking Group, one of the largest financial services providers in the UK whose goals are to be a trusted, sustainable, and responsible business.

The Responsible Business Committee of the Board of Lloyds Banking Group is responsible for overseeing its performance, including that of the Group, as a Responsible Business, and has given much focus to overseeing the development of the Lloyds Banking Group's Helping Britain Recover Plan. This plan continues its strategy of Helping Britain Prosper ambitions, designed to play a part in the UK's recovery from the Covid-19 pandemic. The views of stakeholders have also informed the Responsible Business Committee's role in the development of Lloyds Banking Group's Society of the Future ambitions, which aim to fully integrate its societal objectives, with its business objectives, and will be key in the next phase of its strategy, including that of the Group's strategy where appropriate.

Environmental Ambitions

The Group's strategy in relation to Environmental Ambitions is covered in the Climate Change section commencing on page 5 of this report.

Board Diversity

The Board considers its current size and composition is appropriate to the Group's circumstances and places great emphasis on ensuring its membership reflects the diversity of modern Britain and is inclusive for everyone. On gender diversity, the Board has a specific objective to maintain membership of at least 30 per cent female Board members. At 31 December 2020, the Board's membership consisted of 36 per cent female members. The Board will aim to meet the objectives of the Parker review for at least one Black, Asian and Minority Ethnic Board member by, or as soon as possible after, the target date of 2021. The Group also supports the Lloyds Banking Group's high-level approach to diversity in senior management roles which is governed in greater detail through Lloyds Banking Group policies.

Regulators

The Board and the Group continue to maintain strong, open and transparent relationships with relevant regulators and government authorities. Liaison with regulators and the government, both directly and as part of Lloyds Banking Group, is an ongoing priority at all levels of the organisation, ensuring Lloyds Banking Group, and the Company's strategic aims align with the requirement of these important stakeholders.

Covid-19 Response

Senior leaders worked closely with the Financial Conduct Authority (FCA) in the initial response to the Covid-19 crisis keeping the Board apprised of all developments. This helped ensure the Group's response could best support customers alongside the maintenance of day to day business operations.

As the year progressed the Board remained close to the developing priorities of the government and engaged with the Prudential Regulation Authority (PRA) and the FCA to support the stability of the wider UK economy and regulatory initiatives that reflect the changing demands of wider society.

The Company's Master Trust business is regulated by the Pensions Regulator (tPR) and an ongoing dialogue is maintained between the business and tPR.

GROUP STRATEGIC REPORT (continued)

Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

Regulators (continued)

Regulatory Agenda

Individual Directors have had in the ordinary course of business continuing discussions with the FCA and the PRA on several aspects of the regulatory agenda and, during 2020, this included a heightened level of engagement in respect of managing impacts from the Covid-19 pandemic. The Board, in turn receives regular updates on this and wider Lloyds Banking Group interaction. This provided a view of key areas of FCA focus, alongside progress made on addressing FCA actions.

During 2020, the Board has routinely addressed regulatory feedback provided both through its periodic summary meetings and through other engagement channels. The Group's Board welcomed representatives from both the FCA and the PRA to address its meetings during 2020. A key area of focus for the Board has been adapting to changes in regulatory requirements; embedding the prescribed FCA criteria in the development of the annual fund value assessment process of the Division's ACD business and reporting; and ensuring the fair treatment of customers in action plans.

Suppliers

As part of Lloyds Banking Group, the Group relies on a number of partners for important aspects of its operations and customer service provision. As well as external partners, the Group relies on intra-group supplier arrangements for certain services. The Board recognises the importance of its role in overseeing these relationships which are integral to the Group's future success.

Supplier Experience

Recognising the role of suppliers in the Group's day to day operations, and its future ambitions, the Board undertakes regular reviews of its key suppliers, this includes asset managers and its outsourced service providers, and takes into consideration supplier feedback on the Group's processes for potential improvement.

Supplier Framework

Importance is placed on having the right supplier framework to operate responsibly. Lloyds Banking Group's Sourcing and Supply Chain Management Policy applies to all its businesses, divisions, and subsidiaries, including the Group, with the Directors assuming ultimate responsibility for its application as relevant to the Group. This ensures the most significant supplier contracts receive the approval of the Board, including those which are key in progressing strategic priorities. The framework also ensures appropriate management oversight of supplier spending not considered by the Board, allowing challenge to be made where appropriate, and minimising risks and unnecessary cost.

Suppliers are required to adhere to relevant Lloyds Banking Group policies and comply with its Code of Supplier Responsibility which can be found on the Lloyds Banking Group website. This defines expectations for responsible business behaviour, underpinning the efforts of the Group and Lloyds Banking Group to share and extend good practice. All material contracts are subject to rigorous cost management governance with regular review of key supplier risks.

Modern Slavery

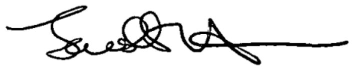
The Responsible Business Committee of the Board of Lloyds Banking Group as part of its oversight of its performance, including that of the Group, as a Responsible Business, governs Lloyds Banking Group's approach to human rights.

On a day to day basis, management of and engagement on modern slavery and human rights is guided by a cross-divisional working group led by the Responsible Business team, which meets regularly to assess the embedding of human rights within Lloyds Banking Group's operations.

Lloyds Banking Group continues to have a zero-tolerance attitude towards modern slavery in its supply chains.

Lloyds Banking Group's Modern Slavery and Human Trafficking Statement and Human Rights Policy Statement are published on its website and cover all its subsidiary companies, including the Group which is required to publish an annual statement, and sets out the steps taken to prevent modern slavery in Lloyds Banking Group's business and supply chains. The Board undertakes a regular review of these Statements.

On behalf of the Board of Directors



J C S Hillman

Director

24 March 2021

DIRECTORS' REPORT

The Directors present the audited consolidated financial statements of the Company and the Group. The Company is a limited Company, domiciled and incorporated in the United Kingdom. The Group also has freedom of services overseas through branches, which administer a relatively small amount of business, principally in Germany. This business is administered through a subsidiary, SWE. Details of all the subsidiary undertakings and the European business Part VII Transfer Scheme to SWE in the prior year are given in note 16 and note 42.

Results and dividend

The result for the year ended 31 December 2020 is a Group loss after tax of £(196) million (2019 loss: £(21) million). The result is reflective of market conditions during the year following Covid-19 impacts, but also reflects the effect of assumption changes, principally expense assumptions. Further information on the results of the Group, and future prospects of the business, are provided in the Group Strategic Report.

During the year, £560 million interim dividends (2019: £300 million) were paid. The Directors recommend no payment of a final dividend in respect of the year ended 31 December 2020 (2019: nil). Details of dividends paid during the year are given in note 35.

Post balance sheet events

There are no post balance sheet events since 31 December 2020 to report.

Directors

The names of the current Directors are listed on page 3. Changes in Directorships during the year and since the end of the year are as follows:

A M Blance	(resigned 14 August 2020)

Particulars of the Directors' emoluments are set out in note 38.

Directors' indemnities

Lloyds Banking Group has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of the Directors period of office. The deed indemnifies the Directors to the maximum extent permitted by law.

The deed for existing Directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Disclosure of information to auditors

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted in accordance with, the provisions of the Companies Act 2006.

Future developments

Future developments are detailed within the Group Strategic Report and also in note 41.

Engagement with suppliers, customers, and others

Disclosures relating to engagement with suppliers, customers and others are included in the Strategic Report and are therefore incorporated into this report by reference.

Employees

Lloyds Banking Group is committed to providing employment practices and policies which recognise the diversity of the workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief. In the UK, Lloyds Banking Group belongs to the major employer groups campaigning for equality for all staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall. Lloyds Banking Group is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission. Involvement with these organisations enables Lloyds Banking Group to identify and implement best practice for staff.

Lloyds Banking Group encourages and gives full and fair consideration to job applications from people with a disability and are unbiased in the way it assesses, selects, appoints, trains and promotes people. Lloyds Banking Group encourages job applications from those with a disability and continues to run a work experience programme with Remploy to support people with disabilities wanting to enter the workplace.

DIRECTORS' REPORT (continued)

Employees (continued)

Lloyds Banking Group is committed to continuing the employment of, and for arranging appropriate training for, employees of the Company who have become disabled persons during the period when they were employed by the Company.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. These meetings, briefings and internal communications also serve to achieve a common awareness of the financial and economic factors that affect the performance of the Company and the Group. There are well-established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions. Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

Corporate Governance Report

Approach to Corporate Governance

In accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018) (the 'Regulations'), for the year ended 31 December 2020, the Group has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the 'Principles'). The following section explains the Group's approach to corporate governance, and its application of the Principles.

Fundamental to the Group's strategy are high standards of corporate governance. A Corporate Governance Framework is in place for the Group, which sets the approach and applicable standards in respect of the Group's corporate governance arrangements whilst addressing the matters set out in the Principles.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management, including decision-making on operational matters such as those relating to credit, liquidity and the day-to-day management of risk, and the governance requirements of the operation of the Group outside of Lloyds Banking Group's Ring-Fenced Bank. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Corporate Governance Framework of the Group further addresses the requirements of the Principles as follows.

Principle One – Purpose and Leadership

The Board is collectively responsible for the long-term success of the Group. It achieves this by agreeing the Group's strategy, within the wider strategy of Lloyds Banking Group, and overseeing delivery against it. The Group's strategy is discussed further in the Strategic Report on pages 4 to 15. The Board also assumes responsibilities for the management of the culture, values and wider standards of the Group, within the equivalent standards set by Lloyds Banking Group.

Consideration of the needs of all stakeholders is fundamental to the way the Group operates, as is maintaining the highest standards of business conduct, which along with ensuring delivery for customers, is a vital part of the corporate culture. The Group's approach is further influenced by the need to build a culture in which everyone feels included, empowered and inspired to do the right thing for customers. To this end, the Board plays a lead role in establishing, promoting and monitoring the Company's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the level of prominence in Board and Executive decision-making which they require. The Group's corporate culture and values closely align to those of Lloyds Banking Group, which are discussed in more detail in the Lloyds Banking Group Annual Report and Accounts for 2020.

Principle Two – Board Composition

The Group is led by a Board comprising a Chair, Independent Non-Executive Directors, other Non-Executive Directors and Executive Directors; further details of the Directors can be found on page 3. The Board considers its composition regularly, and is committed to ensuring it has the right balance of skills and experience. The Board considers its current size and composition is appropriate to the Group's circumstances. The Board places great emphasis on ensuring its membership reflects diversity in its broadest sense, for example four out of eleven Directors are women. New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded Board and the diversity benefits each candidate can bring overall. There are a range of initiatives to help provide mentoring and development opportunities for female and Black, Asian, and Minority Ethnic executives within Lloyds Banking Group, and to ensure unbiased career progression opportunities. Progress on diversity objectives is monitored by the Board and built into its assessment of executive performance.

The Board is supported by its committees, the operation of which is discussed below, which make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk and financial reporting matters. Each committee has written terms of reference setting out its delegated responsibilities. Each committee comprises individuals with appropriate skills and experiences and is chaired by an experienced Chair. The committee Chairs report to the Board at each Board meeting.

DIRECTORS' REPORT (continued)

Corporate Governance Report (continued)

Principle Two – Board Composition (continued)

The Board periodically undertakes reviews of its effectiveness, which provide an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlights areas of further development. The effectiveness reviews are commissioned by the Chair of the Board, assisted by the Company Secretary. In addition to considering the effectiveness of the Board, the effectiveness of the Board committees is also considered. The Chair also ensures that the individual performance of individual Directors is reviewed.

Principle Three – Director Responsibilities

The Directors assume ultimate responsibility for all matters, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation though the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise.

The Board is supported by its committees which make recommendations on matters delegated to them under the Corporate Governance Framework. The management of all committees is in keeping with the basis on which meetings of the Board are managed, with open debate, and adequate time for members to consider proposals which are put forward. The Chair of the Board and each Board Committee assumes responsibility with support from the Company Secretary for the provision to each meeting of accurate and timely information.

Principle Four – Opportunity and Risk

The Board oversees the development and implementation of the Group's strategy, within the context of the wider strategy of Lloyds Banking Group, which includes consideration of all strategic opportunities.

The Board is also responsible for the long-term sustainable success of the Group, generating value for its shareholders and ensuring a positive contribution to society. The Board agrees the Group's culture, purpose, values and strategy - within that of Lloyds Banking Group more widely - and agrees the related standards of the Group, again within the relevant standards of Lloyds Banking Group. Further specific aims and objectives of the Board are formalised within the Corporate Governance Framework.

Strong risk management is central to the strategy of the Group, which along with a robust risk control framework acts as the foundation for the delivery of effective management of risk. The Board agrees the Group's risk appetite, within the wider risk appetite of Lloyds Banking Group, and ensures the Group manages risk effectively, delegating related authorities to individuals through the Corporate Governance Framework and the further management hierarchy. Board-level engagement, coupled with the direct involvement of senior management in risk issues ensures that escalated issues are promptly addressed and remediation plans are initiated where required. The Group's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group, and as such are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Group's principle risks are discussed further in note 37.

Principle Five – Remuneration

The Remuneration Committee of Lloyds Banking Group (the 'Remuneration Committee'), assumes responsibility for the Group's approach to remuneration. This includes reviewing and making recommendations on remuneration policy as relevant to the Group, ranging from the remuneration of Directors to that of all other colleagues employed by the Group. This includes colleagues where the regulators require the Group to implement a specific approach to their remuneration, such as Senior Managers and other material risk takers.

Principle Six – Stakeholders

The Group as part of Lloyds Banking Group operates under Lloyds Banking Group's wider Responsible Business approach, which acknowledges that the Group has a responsibility to help address the economic, social and environmental challenges which the UK faces, and as part of this understand the needs of the Group's external stakeholders, including in the development and implementation of strategy. Central to this is Lloyds Banking Group's Helping Britain Recover plan, in which the Company participates, which seeks to gather stakeholder views through a dedicated materiality study, as overseen by Lloyds Banking Group's Responsible Business Committee.

In 2020, the Responsible Business Committee determined that the Group and Lloyds Banking Group continued to demonstrate responsibility as a key priority, including keeping customers' data safe, supporting vulnerable customers, lending responsibly, supporting businesses and working with suppliers. The approach of the Board in respect of its non colleague stakeholders is described in the separate statement made in compliance with the Regulations, on page 12.

Going concern

The going concern of the Company and the Group is dependent on successfully maintaining adequate levels of capital and liquidity. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the Directors have considered the implications of the Covid-19 pandemic upon the Group's performance and projected funding and capital positions and also taken into account the impact of further stress scenarios as well as a number of key dependencies which are set out in note 37 under principal risks and uncertainties: funding and

DIRECTORS' REPORT (continued)

Corporate Governance Report (continued)

Going concern (continued)

liquidity in note 37(c)(5) and capital position in note 37(c)(4). Additionally the Directors have considered projections for the Group's capital and funding position. Accordingly, the Directors conclude that the Company and the Group have adequate resources to continue in operational existence for a period of at least 12 months from the date of the approval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Hedging and financial risk management

Disclosures relating to hedge accounting are included within note 1 and note 20 to the accounts; disclosures relating to financial risk management are included in note 37 to the accounts and are therefore incorporated into this report by reference.

Information incorporated by reference

The following additional information forms part of the Directors' Report, and is incorporated by reference.

Content		Section
Disclosures required under the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	Statement of other stakeholder engagement	Group Strategic Report
Disclosures required by the Financial Conduct Authority's Disclosure and Transparency Rule 7.2.5R	Corporate Governance Statement - internal control and risk management systems	Note 37 (Risk Management)

Independent auditors

PricewaterhouseCoopers LLP are deemed to be re-appointed under section 487(2) of the Companies Act 2006 for the current year. Deloitte LLP are due to be appointed as auditors for the year ending 31 December 2021.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Company financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. Additionally, the Financial Conduct Authority's Disclosure Guidance and Transparency Rules require the Directors to prepare the Group financial statements in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- state whether for the Group and Company, international accounting standards in conformity with the requirements of the Companies Act 2006 and, for the Group, international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union have been followed, subject to any material departures disclosed and explained in the financial statements
- make judgments and accounting estimates that are reasonable and prudent
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business

The Directors are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. A copy of the financial statements is placed on our website www.scottishwidows.co.uk.

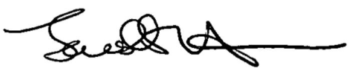
DIRECTORS' REPORT (continued)

Statement of Directors' responsibilities (continued)

Each of the Directors whose names are listed on page 3 confirms that, to the best of their knowledge:

- The Group financial statements, which have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and the Company financial statements which have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006
- the Group Strategic Report on pages 4 to 15, and the Directors' Report on pages 16 to 20 include a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that it faces

On behalf of the Board of Directors



J C S Hillman

Director

24 March 2021

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion, Scottish Widows Limited's Group financial statements and Company financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2020 and of the Group's loss and the Group's and the Company's cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the Group and Company balance sheets as at 31 December 2020; the consolidated statement of comprehensive income, the Group and Company statements of cash flows, the Group and Company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Insurance Audit Committee.

Separate opinion in relation to international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union

As explained in note 1(a) to the Group financial statements, the Group, in addition to applying international accounting standards in conformity with the requirements of the Companies Act 2006, has also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In our opinion, the Group financial statements have been properly prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group headed by Lloyds Banking Group, of which the Company is a member.

Other than those disclosed in note 10 to the financial statements, we have provided no non-audit services to the Company and its controlled undertakings in the period under audit.

Our audit approach

Overview

Audit scope

- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error). We performed audit procedures over one component we considered financially significant in the context of the Group (full scope audit), and over seven components specific audit procedures were performed on certain account balances and transactions. We also performed other procedures including testing entity level controls and analytical review procedures to mitigate the risk of material misstatement in the insignificant components. Procedures were also performed at the Group level over the Group consolidation process.

Key Audit Matters

- Valuation of Insurance Contract Liabilities - Longevity Assumptions (Group and Company)
- Valuation of Insurance Contract Liabilities - Maintenance Expense Assumptions (Group and Company)
- Valuation of Insurance Contract Liabilities - Credit Default Assumptions (Group and Company)
- Valuation of certain illiquid financial instruments (Group and Company)
- Valuation of material conduct provisions (Group and Company)
- Impact of Covid-19 (Group and Company)

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)

Materiality

- Overall Group materiality: £44.7 million (2019: £44.7 million) based on 1.9 per cent of net assets
- Overall Company materiality: £42.4 million (2019: £42.4 million) based on 1.9 per cent of net assets capped at 95 per cent of Group materiality
- Performance materiality: £33.5 million (Group) and £31.8 million (Company)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Capability of the audit in detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined in the Auditors' responsibilities for the audit of the financial statements section, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or increase the capital position of the Group and Company, management bias in accounting estimates, judgmental areas of the financial statements such as the valuation of insurance contract liabilities, conduct provisions and the valuation of illiquid financial instruments. Audit procedures performed by the engagement team included:

- Discussions with the Insurance Board, management, Internal Audit, senior management involved in the Risk and Compliance functions and the Group's and Company's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud
- Evaluation and testing the operating effectiveness of management's entity level controls designed to prevent and detect irregularities
- Reading key correspondence with, reports to and meetings with the Prudential Regulation Authority and the Financial Conduct Authority in relation to compliance with laws and regulations
- Reviewing relevant meeting minutes including those of the Insurance Board and its key sub-committees (including the Risk Oversight Committee and the Insurance Audit Committee)
- Reviewing data regarding policyholder complaints, the Group's and Company's register of litigation and claims, internal audit reports
- Identifying and testing journal entries, which included journal entries posted by unexpected or unusual users, journals where credits were made to revenue with the debits recorded against unexpected balance sheet accounts, journals posted with descriptions indicating a higher level of risk and journals posted late with favourable impact on financial performance
- Challenging assumptions and judgements made by management in their accounting estimates, in particular in relation to the valuation of life insurance liabilities; conduct risk and provisions and the valuation of illiquid financial instruments (see related key audit matters below)
- Testing of significant one-off transactions
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)

This is not a complete list of all risks identified by our audit.

Impact of Covid-19 is a new key audit matter this year. Otherwise, the key audit matters below are consistent with last year.

<table>
<tr><th>Key audit matter</th><th>How our audit addressed the key audit matter</th></tr>
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Valuation of Insurance Contract Liabilities - Longevity Assumptions (Group and Company)

Refer Group and Company Note 1(u) 'Accounting Policies' , Note 2(a) 'Critical Accounting judgements and estimates', Note 25 'Insurance contract and participating investment contract liabilities' and Note 36 'Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities'

These assumptions reflect how long policyholders receiving annuity payments are expected to live and how that might change over time. Small changes to these assumptions can have a material impact on the valuation of the Group's and Company's insurance and participating investment contracts ("insurance contract liabilities"). The impact of the Covid-19 pandemic throughout the year has introduced additional uncertainty to these assumptions with medium and long term health implications for society uncertain at this time.

There are two main components to the longevity assumptions:

- Base mortality assumption: this component is derived using past mortality experience to select a suitable set of mortality tables. The process for setting the base mortality assumptions traditionally requires less judgement than setting mortality improvements.
- Mortality improvement assumption: this component is determined by choosing an appropriate projection model. The most common model in operation is the Continuous Mortality Investigation (CMI) model which is updated with new data on an approximately annual basis. The Group has adopted the most recent available model and dataset (CMI 2019). Given the uncertainty of future mortality trends, the choice of model, and the parameterisation of the model requires significant judgement. In addition, a margin for prudence is applied to the annuitant mortality assumptions.

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In respect of the longevity assumptions, we performed the following:

- Tested the design and operating effectiveness of controls over the accuracy and completeness of the data used in the experience analysis
- Validated the appropriateness of the methodology used to perform the annual experience analyses. We completed this with reference to relevant rules, actuarial guidance and by applying our industry knowledge and experience.

This included:

  - Evaluating management's choice of, and fitting to, internally developed mortality base tables
  - Validating the appropriateness of areas of expert judgements used in the development of the mortality improvement assumptions, including the selection and parameterisation of the CMI model

- Tested the controls in place around the performance of annuitant mortality experience analysis studies, approval of the proposed assumptions and implementation within actuarial models
- Assessed the appropriateness of the IFRS prudence margin and its consistency over time
- Compared the annuitant mortality assumptions selected by management against those used by their peers using our annual survey of the market
- In respect of the Covid-19 pandemic, we have assessed management's considerations of potential changes in current and future expected rates of annuitant mortality and their conclusion not to include an adjustment in their long term longevity assumptions in relation to this
- Assessed the disclosure of the annuitant mortality assumptions, changes in these assumptions over 2020 and their sensitivities.

Based on the audit procedures performed and evidence obtained, we consider the longevity assumptions used in the valuation of insurance contract liabilities to be appropriate.

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INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)

Valuation of Insurance Contract Liabilities - Maintenance Expense Assumptions (Group and Company)

Refer Group and Company Note 1(u) 'Accounting Policies' , Note 2(a) 'Critical Accounting judgements and estimates', Note 25 'Insurance contracts and participating investment contract liabilities' and Note 36 'Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities'

These assumptions reflect the expected future expenses that will be required to maintain insurance contracts existing at the balance sheet date to maturity. Small changes to these assumptions can have a material impact on the valuation of the Group's and Company's insurance and participating investment contracts ("insurance contract liabilities").

Judgement is required to identify all expenses which are attributable to the Group's and Company's insurance business, identify the subset of total expenses that are required to maintain the in-force insurance contracts, to allocate these expenses between product types and to make adjustments where the best estimate is that these expenses will change in the future.

The impact of the Covid-19 pandemic throughout the year and the associated effect on the economy has introduced additional uncertainty to these assumptions.

We performed the following procedures over maintenance expenses:

- We assessed the appropriateness of the judgements in respect of costs deemed to be non-attributable to insurance business, such as recharges to the Group from Lloyds Banking Group which were not considered to be required to maintain the insurance contracts in force at the balance sheet date
- We audited the split between those costs attributed to in-force policies, and those which were incurred in the writing of new business, including additional costs arising from changes to operations caused by Covid-19. These latter costs are not capitalised in actuarial reserves
- We evaluated the sufficiency of future project-related costs attributable to the Group's in-force business, such as estimates of costs of implementation of future accounting standards
- We assessed the allocation of costs to product types and the resulting per-policy expense assumption
- We assessed the potential impact of the Covid-19 pandemic on the projected expense base by considering whether certain incurred costs would be an appropriate estimate of future expense

Based on the work performed and the evidence obtained, we consider the assumptions used for maintenance expenses to be appropriate.

Valuation of Insurance Contract Liabilities - Credit Default Assumptions (Group and Company)

Refer Group and Company Note 1(u) 'Accounting Policies' , Note 2(a) 'Critical Accounting judgements and estimates', Note 25 'Insurance contracts and participating investment contract liabilities' and Note 36 'Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities'

This set of assumptions reflect the credit default risk associated with the assets held to back the portfolio of annuity liabilities.

The assumptions are used to derive the valuation interest rate (VIR) which is used in the calculation of the annuity liabilities. There is a significant level of judgement applied in order to set this assumption.

Small changes to these assumptions can have a material impact on the valuation of the Group's and Company's insurance and participating investment contracts ("insurance contract liabilities"). The impact of the Covid-19 pandemic throughout the year and the associated effect on the economic environment has introduced additional uncertainty to these assumptions.

In respect of the credit default assumptions, we performed the following:

- Assessed the appropriateness of the methodology adopted by management against relevant rules and actuarial guidance, in addition to applying our industry knowledge and experience
- Assessed the assumptions used by management and challenged the rationale for the judgements applied
- Assessed the appropriateness of the prudence margin and its consistency over time and challenged management to demonstrate that the level of prudence within the basis remains sufficient despite current economic conditions
- Considered the impact of Covid-19, including whether recent defaults and downgrades are appropriately allowed for in data used by management, and whether any changes in future expected levels are appropriately reflected
- Compared the assumptions selected against those adopted by peers using our annual survey of the market.

Based on the work performed and the evidence obtained, we consider the assumptions used for credit default risk within the calculation of the valuation interest rate to be appropriate.

Valuation of certain illiquid financial instruments - Group and Company *Refer Group and Company Notes 1 (d) and 1(p) 'Accounting policies', Note 2 (c) 'Critical Accounting judgements and estimates', Note 22 'Investments at fair value through profit or loss' and Note 37 'Risk management'.* The Group and Company hold a significant portfolio of illiquid financial instruments to back their long term insurance contract liabilities. This portfolio comprises infrastructure, social housing, education and commercial real estate loans, lifetime mortgages, and agricultural loans. Models have been developed to value these financial instruments. The inputs to these models require judgement to determine the discount rates applied to the future contractual cash flows, particularly in respect of the credit risk of the borrowers. The impact of the Covid-19 pandemic has resulted in additional uncertainty in relation to the credit risk. Small changes in the assumptions made by management could result in a material impact on the valuation of these portfolios.	We have performed the following procedures over the portfolio of illiquid financial instruments that back the long term insurance liabilities: Key data utilised by management in the models used to value each of these asset types - including key loan or mortgage data, and market available indices and reference bond data - has been tested on a sample basis to ensure its accuracy. Understood the key process and controls relating to the valuation of these portfolios, including: • Review of the monthly movements in valuation of each portfolio • Monthly review of portfolio position by the Fair Value Pricing Committee • Model change processes in place for management's valuation models Engaged with our valuations experts to review management's valuation methodologies, the calibration of year end assumptions, and the implementation of the above within management's valuation models. Across all portfolios this has included; • Assessing management's valuation methodology including the impact of the Covid-19 pandemic, particularly on the credit risk assumptions • Challenging the calibration of key assumptions as at the reporting date based on independent analysis and benchmarking • An overall assessment of the reasonableness of the final fair value of the assets, with reference to market information. Our audit work in respect of the valuation of infrastructure, social housing, education, and commercial real estate loans specifically included; • Evaluating key assumptions including illiquidity premium against our own expectations based on latest available market information and benchmarking • Assessing the appropriateness of management's internal credit rating methodology, and reviewing its implementation by reviewing a sample of credit files • Assessing the implementation of the above methodology and assumptions by building an independent model. Our audit work in respect of the valuation of the lifetime mortgages specifically included; • Evaluating key assumptions including mortality, property growth, and notional interest rates used in formulating the discount rate for the future cash flows against our own expectations based on latest available market information and benchmarking • Assessing the implementation of the above methodology and assumptions by reviewing code underlying management's valuation model. Our audit work in respect of the valuation of the agricultural mortgages specifically included; • Evaluating key assumptions including illiquidity premium against our own expectations based on latest available market information and benchmarking; • Assessing the appropriateness of management's assigned credit ratings based on independent analysis and historic performance of the portfolio; and • Assessing the implementation of the above methodology and assumptions by building an independent model. We are satisfied that the models and assumptions used are reasonable for the year end reporting valuation of the illiquid financial instruments.

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Valuation of material conduct provisions (Group and Company)

Refer Group and Company Note 1 (v) 'Accounting policies', Note 2 (d) 'Critical Accounting judgements and estimates' and Note 28 'Provisions for other liabilities and charges'.

Matters relating to conduct of business practices, and specifically the Group and Company's anticipated customer redress payments and operational costs continue to be significant. Provisions have been made by the Group and the Company in respect of conduct matters in recent years, most materially relating to policies issued by the Company under its former name of Clerical Medical Investment Group Limited but sold by independent intermediaries in Germany, principally during the late 1990's and early 2000's.

The measurement of the provision in respect of these policies is highly judgemental given the uncertainty over the volume of future complaints and the cost of redress. These are considered to be significant assumptions.

There is a financial reporting risk that the provision in relation to German claims is not appropriately disclosed in the financial statements and that the valuation of the provision is misstated.

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For the material provision relating to German policies identified, we have performed the following procedures:

- Understood and tested the governance process and approval of model assumptions and outputs
- Challenged the assumptions set by management and used within the provision and tested their application to supporting evidence
- Checked the mathematical accuracy of management's calculations
- Compared future expectations with past experience
- Assessed the sensitivities disclosed within the Annual Report and Accounts
- Read correspondence with the Financial Conduct Authority and Prudential Regulation Authority
- Assessed correspondence from external lawyers and discuss with internal legal counsel as appropriate
- Read the minutes of key governance meetings and attended meetings of the Insurance Audit Committee and Risk Oversight Committee.

We are satisfied that the models and assumptions used are appropriate for a best estimate provision for year end reporting, given current evidence available at this time and that the disclosures made are appropriate.

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Impact of Covid-19 (Group and Company)

As disclosed in the Group Strategic Report, Note 36 'Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities', and Note 37 'Risk management'. The impacts of the global pandemic due to Covid-19 continue to cause significant social and economic disruption up to the date of reporting. In our audit we have identified the following key impacts of Covid-19 to consider:

Ability of the entity to continue as a going concern.
There are a number of potential matters in relation to Covid-19 which could impact on the going concern status of the Group and Company. The Directors have considered the implications of the Covid-19 pandemic upon the Group's performance and projected funding and capital positions and also taken into account the impact of further stress scenarios as well. The Directors have concluded that the Group and Company are a going concern.

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In assessing management's consideration of the impact of Covid-19 on the Group and Company we have performed the following procedures:

- Obtained, evaluated and challenged management's updated going concern assessment (specifically covering current and projected capital and liquidity positions) using our knowledge of the Group's business performance and review of regulatory correspondences
- Obtained the Group and Company's four-year operating plan (which is used in management's assessment). We performed lookback testing over budgeted vs. actual income for the previous three years to assess the historical accuracy of management's forecasting
- Considered information obtained during the course of the audit and publicly available market information to identify any evidence that would contradict management's assessment of the impact of Covid-19
- Inquired and understood the actions taken by management to mitigate the impacts of Covid-19, including review attendance of all Risk and Audit Committees

We agree with the Director's conclusions in respect of going concern.

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Impact on Estimation Uncertainty in the Financial Statements. The pandemic has increased the level of estimation uncertainty in the financial statements. The Directors have therefore considered how Covid-19 has impacted the key estimates that determine the valuation of material balances, particularly the insurance contract liabilities and illiquid financial instruments.	• Considered whether there has been any impacts on the design and operating effectiveness of key controls impacting the preparation of financial statement information • Assessed actual experience over 2020 impacting the demographic and economic assumptions • Challenged management's judgements to derive the longevity and credit default assumptions used to determine the insurance contract liabilities in light of the Covid-19 experience emerging and by comparing these relative to the Group and Company's industry peers • With consideration of the impacts of the pandemic, identified sectors at higher risk and obtained evidence of management's credit risk assessments for relevant illiquid assets. We have audited the balances impacted by estimation uncertainty and believe the values presented in the Financial Statements to be reasonable.
Qualitative Disclosures in the Annual Report. In addition the Directors have considered the qualitative disclosures included in the Annual Report in respect of Covid-19 and the impact that the pandemic has had, and continues to have, on the Group and Company.	• Reviewed the appropriateness of disclosures within the Annual Report with respect to Covid-19 and where relevant checked the material consistency of other information to the audited financial statements. Based on the audit procedures performed and evidence obtained, we consider the disclosure of Covid-19 in the Annual Report to be appropriate.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the company, the accounting processes and controls, and the industry in which they operate.

The Group consists of one main life insurance Company, Scottish Widows Limited, and a number of subsidiaries, as set out within note 16 to the consolidated financial statements. The company itself is comprised of a number of reporting units, each of which represents a separate component. The subsidiaries of Scottish Widows Limited are aggregated into a number of reporting units, each of which is also deemed to represent a separate component. In establishing the overall approach to the Group audit, we determined the type of work that was required to be performed over each component. One component (being the UK reporting unit of Scottish Widows Limited) was considered individually financially significant in the context of the Group's consolidated financial statements. It contributed greater than 90 per cent of Group net assets and greater than 95 per cent of Group premiums net of reinsurance and was deemed to be a full scope component. We considered the individual financial significance of other components in relation to primary statement account balances, as well as the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). Any component which contributes a significant proportion of one or more primary statement account balances was subject to specific audit procedures over those account balances. We performed such procedures within seven components, in addition to the UK reporting unit of Scottish Widows Limited. All remaining components were subject to procedures which mitigated the risk of material misstatement including testing of entity level controls, information technology general controls and Group and component level analytical review procedures. All audit work was undertaken by the Group engagement team.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Financial statements – Group	**Financial statements – Company**
*Overall materiality**	£44.7 million (2019: £44.7 million).	£42.4 million (2019: £42.4 million).
How we determined it	We consider a consistent overall materiality to the prior year to be appropriate, which equates to 1.9 per cent of net assets.	1.9 per cent of net assets capped at 95 per cent of group materiality.
Rationale for benchmark applied	In determining our overall materiality, as there have been no significant changes to the underlying business, we consider that the prior year materiality is still appropriate for both the Group and Company. In making this judgement we have considered a range of benchmarks which we believed to be relevant, including net assets, written premiums, earnings and funds under management. The management of the Scottish Widows Limited group is focused on managing capital held under Solvency II reporting and which is also relevant for the release of dividends to its ultimate parent company, Lloyds Banking Group; the value of funds under management; the liquidity of the business and its ability to meet the daily requirements of its policyholders. We have also compared our overall materiality to materialities used to the key users of the financial statements, being Lloyds Banking Group and the PRA who regulate solvency, and compared our overall materiality to key balances in the financial statements such as total assets, insurance contract liabilities, gross written premium, net investment income and gross claims and benefits paid. Following the above consideration, and applying professional judgement, we consider that retaining a consistent materiality to the prior year is appropriate and that this equates to 1.9 per cent of net assets.	Company materiality has been capped at 95 per cent, which equates to £42.4 million to reflect its allocation of materiality for the purpose of the Group audit.

*Movements in unit linked assets have an equal and opposite movement in unit linked liabilities and therefore a specific materiality can be applied for any unit linked balance sheet risk. We have determined the unit linked materiality on a benchmark of 1.0 per cent of total unit linked assets for the Group, capped at £100 million.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £1.56 million and £42.4 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75 per cent of overall materiality, amounting to £33.5 million for the group financial statements and £31.8 million for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Insurance audit committee that we would report to them misstatements identified during our audit above £2.23 million (Group audit) (2019: £2.23 million) and £2.23 million (Company audit) (2019: £2.23 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)

Conclusions relating to going concern

Our evaluation of the Directors' assessment of the Group's and the Company's ability to continue to adopt the going concern basis of accounting included:

- Obtaining, evaluating and challenging management's updated going concern assessment (specifically covering current and projected capital and liquidity positions) using our knowledge of the Group's business performance and review of regulatory correspondence
- Obtaining the Group and Company's four-year operating plan (which is used in management's assessment). We also performed lookback testing over budgeted vs. actual income for the previous three years to assess the historical accuracy of management's forecasting
- Considering information obtained during the course of the audit and publicly available market information to identify any evidence that would contradict management's assessment of the impact of Covid-19
- Inquiring and understanding the actions taken by management to mitigate the impacts of Covid-19, including review attendance of all Risk and Audit Committees

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the group's and the company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Group Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Group Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Group Strategic Report and Directors' Report for the year ended 31 December 2020 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Group Strategic Report and Directors' Report.

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on pages 19 to 20, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the group's and the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the group or the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's member as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

<u>OTHER REQUIRED REPORTING</u>

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us
- certain disclosures of Directors' remuneration specified by law are not made
- the company financial statements are not in agreement with the accounting records and returns

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Insurance Audit Committee, we were appointed by the Directors on 30 April 2009 to audit the financial statements for the year ended 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement is 12 years, covering the years ended 31 December 2009 to 31 December 2020.

Sue Morling (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Bristol

24 March 2021

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2020

	Note	2020 £m	2019 £m
		Group	*Group*
Revenue			
Gross earned premiums	3	8,205	9,320
Premiums ceded to reinsurers		(333)	(329)
Premiums net of reinsurance		7,872	8,991
Fee and commission income	4	197	232
Investment income	5	3,230	4,115
Net gain on assets and liabilities at fair value through profit or loss	6	1,660	11,525
Gain on transfer of business	7	—	192
Other operating income	8	97	180
Total revenue		13,056	25,235
Expenses			
Gross claims and benefits paid		(7,546)	(8,703)
Claims recoveries from reinsurers		322	301
		(7,224)	(8,402)
Change in liabilities arising from insurance contracts and participating investment contracts	25	(4,931)	(12,669)
Change in liabilities arising from non-participating investment contracts		(1,584)	(2,681)
Change in assets arising from reinsurance contracts held	18	1,423	1,909
Change in unallocated surplus	26	73	(22)
		(5,019)	(13,463)
Net loss/(profit) attributable to external interests in collective investment vehicles		177	(1,824)
Operating expenses	9	(1,044)	(1,202)
Expenses for asset management services received		(167)	(190)
Finance costs	11	(75)	(85)
		(1,109)	(3,301)
Total expenses		(13,352)	(25,166)
(Loss)/profit before tax		(296)	69
Taxation credit/(charge)	12	100	(90)
Loss after tax		(196)	(21)
Loss for the year		(196)	(21)
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Currency translation differences		8	17
		8	17
Other comprehensive income, net of tax		8	17
Total comprehensive loss for the year		(188)	(4)
Total comprehensive loss		(188)	(4)
Total comprehensive loss for the year		(188)	(4)

The notes set out on pages 35 to 118 are an integral part of these financial statements.

BALANCE SHEETS AS AT 31 DECEMBER 2020

		31 December 2020		31 December 2019	
	Note	£m	£m	£m	£m
		Group	Company	Group	Company
ASSETS					
Intangible assets including insurance intangible assets	13	100	59	102	65
Deferred costs	14	1,635	1,628	1,635	1,625
Current tax recoverable	15	123	116	50	41
Investment in subsidiaries	16	—	463	—	624
Investment properties	17	3,324	120	3,523	132
Assets arising from reinsurance contracts held	18	20,359	20,368	23,557	23,563
Other assets	19	125	99	120	95
Derivative financial instruments	20	5,224	5,132	3,968	3,894
Loans and receivables at amortised cost	21	1,018	615	997	619
Investments at fair value through profit or loss	22	146,552	136,633	137,157	127,862
Cash and cash equivalents	23	218	95	276	98
Total assets		178,678	165,328	171,385	158,618
EQUITY AND LIABILITIES					
Capital and reserves attributable to the Group's equity shareholder					
Share capital	24	70	70	70	70
Share premium		1	1	1	1
Retained profits		2,265	2,338	3,013	3,085
Total equity		2,336	2,409	3,084	3,156
Liabilities					
Insurance contracts and participating investment contract liabilities	25	115,965	115,487	110,919	110,599
Unallocated surplus	26	339	339	412	412
		116,304	115,826	111,331	111,011
Future profits on non-participating business in the With Profits Funds	27	(53)	(53)	(49)	(49)
Deferred tax liabilities	15	147	155	266	265
Provisions for other liabilities and charges	28	120	50	141	80
Accruals and deferred income	29	31	21	35	24
Subordinated debt	30	1,892	1,923	1,795	1,820
Non-participating investment contract liabilities	31	38,448	38,433	37,456	37,455
Derivative financial instruments	20	4,609	4,590	3,445	3,434
Other financial liabilities	32	2,214	1,972	1,889	1,422
External interests in collective investment vehicles		12,620	—	11,966	—
Borrowings	33	2	2	3	—
Lease Liabilities	39	8	—	23	—
Total liabilities		176,342	162,919	168,301	155,462
Total equity and liabilities		178,678	165,328	171,385	158,618

Retained earnings for the Company includes profit/(loss) for the year of £(187)m (2019: £(229)m).

The notes set out on pages 35 to 118 are an integral part of these financial statements.

The financial statements on pages 31 to 32 were approved by the Board on 18 March 2021, and signed on behalf of the Board:

J C S Hillman

Director

24 March 2021

STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2020

		2020		2019	
	Note	£m	£m	£m	£m
		Group	Company	Group	Company
Cash flows from operating activities					
Net (Loss)/profit before tax		(296)	(337)	69	(219)
Adjusted for:					
Amortisation of intangible assets	13	10	6	16	13
Finance costs	11	75	72	85	82
Impairment in investment in subsidiary	16	—	233	—	—
Dividends received		—	(194)	—	(7)
Gain on transfer of business		—	—	—	(157)
Capital injections to subsidiaries		—	(72)	—	—
Acquisition of Zurich savings business	42	—	—	(9)	(9)
Net decrease in operating assets and liabilities	34	881	760	491	819
Repayment of subordinated debt		—	—	53	53
Currency translation differences		8	—	17	(15)
Taxation paid		(92)	(35)	(170)	(68)
Net cash flows generated from operating activities		586	433	552	492
Cash flows from investing activities					
Addition of intangible assets	13	(8)	—	(20)	(16)
Acquisition of Zurich savings business	42	—	—	9	9
Dividends received		—	194	—	7
Net cash flows (used in)/generated from investing activities		(8)	194	(11)	—
Cash flows from financing activities					
Dividends paid	35	(560)	(560)	(300)	(300)
Repayment of subordinated debt	30	—	—	(53)	(53)
Finance costs paid	11	(75)	(72)	(85)	(82)
Net cash flows used in financing activities		(635)	(632)	(438)	(435)
Net (decrease)/increase in cash and cash equivalents		(57)	(5)	103	57
Cash and cash equivalents at the beginning of the year		273	98	170	41
Net cash and cash equivalents at the end of the year	23	216	93	273	98

The notes set out on pages 35 to 118 are an integral part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2020

Group

	Note	Share capital £m	Share premium £m	Retained profits £m	Total equity £m
Balance as at 1 January 2019		70	1	3,317	3,388
Loss for the year		—	—	(21)	(21)
Other comprehensive income					
Currency translation		—	—	17	17
Total comprehensive loss for the year		—	—	(4)	(4)
Dividend		—	—	(300)	(300)
Balance as at 31 December 2019		70	1	3,013	3,084
Loss for the year		—	—	(196)	(196)
Other comprehensive income					
Currency translation		—	—	8	8
Total comprehensive loss for the year		—	—	(188)	(188)
Dividend		—	—	(560)	(560)
Balance as at 31 December 2020		70	1	2,265	2,336

Company

	Note	Share capital £m	Share premium £m	Retained profits £m	Total equity £m
Balance as at 1 January 2019		70	1	3,628	3,699
Total comprehensive loss for the year		—	—	(229)	(229)
Currency translation differences		—	—	(14)	(14)
Dividend		—	—	(300)	(300)
Balance as at 31 December 2019		70	1	3,085	3,156
Total comprehensive loss for the year		—	—	(187)	(187)
Dividend		—	—	(560)	(560)
Balance as at 31 December 2020		70	1	2,338	2,409

Not all of the above amounts can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 37.

The notes set out on pages 35 to 118 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

1. Accounting policies

The accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all periods presented in these financial statements unless stated otherwise, are set out below.

(a) Basis of preparation

The financial statements of the Group and Company have been prepared:

(1) in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. Additionally, the financial statement of the Group has been prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

(2) in respect of the Group's and Company's With Profits Funds liabilities, which are measured using an assessment that uses the pre-Solvency II traditional regulatory assessment, grandfathered under IFRS 4 'Insurance Contracts'; and

(3) under the historical cost convention, as modified by the revaluation of investment properties and certain financial assets and financial liabilities at fair value through profit or loss, as set out in the relevant accounting policies

The Directors are satisfied that the Group and Company have adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Group and Company have been prepared on a going concern basis.

In accordance with IAS 1 'Presentation of Financial Statements', assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Group and Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

The Group has taken advantage of the provisions of section 408 of the Companies Act 2006 and has not disclosed a statement of comprehensive income and related notes in respect of the Company.

Standards and interpretations effective in 2020

The Group has adopted the following amendments to IFRS as at 1 January 2020. Adoption has had no significant impact on the financial position of the Group.

- Amendments to IAS 1, Presentation of Financial Statements, and IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, which clarify the definition of 'materiality' and how it should be applied
- Amendments to IFRS 9, Financial Instruments, IAS 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures, is the first phase of the IASB's IBOR Reform, and provides temporary relief from specific hedge accounting requirements to address potential effects of the uncertainly in the lead up to IBOR reform
- Amendments to IFRS 16, Leases, Covid-19-Related Rent Concessions, permit lessees not to assess whether eligible Covid-19 related rent concessions are lease modifications, and account for them as if they were not lease modifications

Details of standards and interpretations in issue but which have not been adopted early are set out at note 41.

(b) Basis of consolidation

The assets, liabilities and results of Group undertakings (including structured entities) are included on the basis of financial statements made up to the reporting date. Group undertakings include all entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. This generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of substantive rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity and the Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of these elements.

Collective investment vehicles and limited partnerships ('investment vehicles') where the Group has control, in part through its long-term funds, are consolidated. Control arises where the Group has substantive rights to remove the external decision maker of the investment vehicle, and has a significant exposure to variable returns from the beneficial interest it holds in the investment vehicle.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(b) Basis of consolidation (continued)

Where a subsidiary or related party of the Group acts as the decision maker of an investment vehicle the Group considers a number of factors in determining whether it acts as principal and therefore controls the investment vehicle including: an assessment of the scope of the Group's decision-making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as decision maker; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle.

Consolidation can be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interest of parties other than the Group are reported within liabilities as external interests in collective investment vehicles. Where a limited partnership is consolidated the non-controlling interest is reported in equity. Group undertakings are fully consolidated from the date on which the ability to exercise control is transferred to the Group and cease to be consolidated from the date on which the ability to exercise control ceases.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the Group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intragroup transactions, balances and gains and losses on transactions between Group companies have been eliminated.

All the financial statements included are uniformly prepared in conformity with IFRSs and the Group's accounting policies and have adopted consistent accounting policies as at 31 December 2020 and 31 December 2019.

(c) Product classification

The Group issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts

Insurance contracts are those contracts which transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time.

Investment contracts

Any long-term contracts not considered to be insurance contracts under IFRSs because they do not transfer significant insurance risk are classified as investment contracts. Such contracts are further analysed between those with and without a discretionary participation feature (DPF). Contracts containing a DPF are referred to as participating investment contracts and those without a DPF as non-participating investment contracts.

A DPF is a contractual right that gives investors the right to receive, as a supplement to guaranteed benefits, additional discretionary benefits or bonuses that are likely to be a significant portion of the total contractual benefits, through participation in the surplus arising from the assets held in the fund. The Group has the discretion within the constraints of the terms and conditions of the contract to allocate part of this surplus to the policyholders and part to the Group's shareholder. Participating investment contracts are accounted for in the same manner as insurance contracts in accordance with the requirements of IFRS 4 'Insurance Contracts'.

Non-participating investment contracts are contracts that neither transfer significant insurance risk nor contain a DPF.

Hybrid contracts

For certain investment contracts, the contract can be partly invested in units which contain a DPF and partly in units without. Where switching levels for similar contracts are deemed to be significant, new investment contracts which contain an option to switch into investment contracts with DPF have been classified as participating investment contracts. Where the switching levels are not deemed to be significant, a new contract is split, with units containing a DPF being allocated as a participating investment contract and the units without a DPF as a non-participating investment contract. Investment contracts which were in-force when IFRS was implemented in 2005 were classified according to the switching levels observed at the time and retain their original classification. For certain investment contracts, the contract can be partly invested in units which contain a DPF and partly without. Where the contract is split, part is allocated as a non-participating investment contract and part as a participating investment contract.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(c) Product classification (continued)

Financial assets and financial liabilities

Management determines the classification of its financial assets and financial liabilities at initial recognition. Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies.

On initial recognition, financial assets are classified as measured at amortised cost or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare.

The Group initially recognises loans, debt securities and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

Derivative assets (other than a derivative which is a designated and effective hedging instrument) are classified as held for trading. With the exception of derivative liabilities, no liabilities are classified as held for trading.

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, both in the normal course of business and in the event of default, and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(d) Fair value methodology

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed, are categorised into a 'fair value hierarchy' as follows:

(i) Level 1

Valued using quoted prices in active markets for identical assets and liabilities to those being valued. An active market is one in which similar arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an on-going basis. Examples include listed equities, listed debt securities, Open Ended Investment Companies (OEICs) and unit trusts traded in active markets, and exchange traded derivatives such as futures.

(ii) Level 2

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar (but not identical) instruments in active markets
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates)
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

Examples of these are securities measured using discounted cash flow models based on market observable swap yields such as Over the Counter interest rate swaps, listed debt and restricted equity securities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(d) Fair value methodology (continued)

(iii) Level 3

Valuations are based on mathematical models, market prices/data (where available) and subjective assumptions, including unobservable inputs. Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Group considers that market participants would use in pricing the asset or liability, for example private equity investments held by the Group and Company. Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible.

Examples of Level 3 assets include portfolio of illiquid loans and advances to customers, investments in private debt funds, private equity shares and complex derivatives.

Further analysis of the Group’s and Company’s instruments held at fair value is set out at note 37. The Group’s management, through a Fair Value Pricing Committee, review information on the fair value of the Group’s financial assets and the sensitivities to these values on a regular basis.

Transfers between different levels of the fair value hierarchy are deemed to have occurred at the next reporting date after the change in circumstances that caused the transfer.

(e) Revenue recognition

Premiums

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when they become payable by the policyholder and are shown before deduction of commission. Premiums ceded to reinsurers are recognised when the related gross premiums are recognised. Gross and ceded premiums are recorded through the relevant lines in the statement of comprehensive income.

Fee and commission income

The Group receives on-going investment management fees which are recognised as revenue as the investment management services are provided on a daily basis throughout the life of the investment.

The Group also receives initial investment management fees in the form of an adjustment, or charge, to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The income is recognised through the statement of comprehensive income, within fee and commission income. The liability is recognised in the balance sheet within accruals and deferred income until recognition criteria are met.

Investment income

Interest income for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income.

Dividends receivable in respect of listed shares and collective investment vehicles are recognised on the date that these are quoted ex-dividend; other dividend income is recognised when the right to receive the dividend is established. All dividends received are recognised through the statement of comprehensive income, within investment income.

Rental income in respect of investment properties is recognised on a straight line basis over the term of the lease. The costs of incentives are recognised as a reduction of total income over the term of the lease on a straight line basis.

Net gains and losses on assets and liabilities at fair value through profit or loss

Net gains and losses on assets and liabilities at fair value through profit or loss includes both realised and unrealised gains and losses. Movements are recognised in the statement of comprehensive income in the period in which they arise.

Other operating income

Within other operating income are rebates of annual management charges from external fund managers. Rebates are recognised when they are earned, as performance obligations are satisfied.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(f) Accruals and deferred income

For non-participating investment contracts, the recognition of income is governed by IFRS 15. Income received for services to be provided in future periods is deferred and recognised in the statement of comprehensive income as the performance obligation is met. Estimation is required of the period that the business is expected to remain in-force and an assessment of the duration of the Group's performance obligations are required for contracts which do not have a fixed maturity date. Further information on this liability is given in note 29.

(g) Expense recognition

Claims

Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified. Claims recoveries from reinsurers are recognised when the related claims are recognised. Claims and claims recoveries are recognised through the relevant lines in the statement of comprehensive income. Claims handling costs and interest on late claims are also included in claims.

Operating expenses

Commission paid in respect of the business written by the Group is recognised through the statement of comprehensive income, within operating expenses. Where certain criteria are met, commission and other acquisition costs may be deferred. The circumstances under which such costs are deferred are set out at policy (j).

Other operating expenses are recognised in the statement of comprehensive income as incurred, within operating expenses.

Expenses for asset management services received

Expenses for asset management services received are recognised in the statement of comprehensive income as they accrue, within expenses for asset management services received.

Finance costs

Interest expense for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within finance costs.

(h) Leases

Assets leased to third parties, including properties leased to tenants, are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee, otherwise they are classified as operating leases. Operating lease rental income and expenditure are recognised on a straight-line basis over the life of the leases through the statement of comprehensive income, within investment income and operating expenses respectively. Properties leased out to tenants under operating leases are included in investment properties in the balance sheet.

The Group has ground rent commitments on its investment properties, these commitments are accounted for as leases. The lease payments are discounted using the Group's incremental borrowing rate and the Group recognises the lease liabilities and a corresponding right-of-use asset in the balance sheet. The right-of-use asset is classified as investment property and is subsequently measured at fair value. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

(i) Intangible assets including insurance intangible assets

(i) Acquired value of in-force business

Insurance and investment contracts acquired in business combinations (other than business combinations of entities under common control) are initially measured at fair value at the time of acquisition and subsequently held at amortised cost. The initial fair value includes the recognition of an acquired value of in-force ('acquired VIF') asset which reflects the present value of future cash flows expected from the business acquired. The asset is shown gross of attributable tax and a corresponding deferred tax liability has been established.

Amortisation of the acquired VIF balance and related tax is carried out on a best estimate basis over the estimated life of the contracts. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the acquired VIF balance is tested for impairment at each reporting date or when there is an earlier indication of impairment (further information on the Group's impairment policy is set out at policy (r)). Such an asset is not recognised in respect of future profits on contracts written in the normal course of business.

(ii) Software development costs

Costs that are directly associated with the acquisition of software licences and the production of identifiable and unique software products controlled by the Group, and that is expected to generate economic benefits exceeding costs beyond one-year, are recognised as intangible assets, subject to de minimis limits.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(i) Intangible assets including insurance intangible assets (continued)

(ii) Software development costs (continued)

Direct costs include the software development team's employee costs and an appropriate portion of relevant overheads. All other costs associated with developing or maintaining computer software programmes are recognised through the statement of comprehensive income as an expense as incurred, within operating expenses.

Computer software development costs recognised as assets are valued at cost and amortised using the straight-line method over their expected useful lives, not exceeding a period of seven years. Subsequent expenditure is only capitalised when it increases the expected future economic benefits of the specific asset to which it relates. The amortisation charge for the year in respect of software licences and software development costs is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the assets is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (r).

(iii) Goodwill

Goodwill arises on business combinations and represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the statement of comprehensive income and is not subsequently reversed. Further information on the Group's impairment policy is set out at policy (r). At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

(j) Deferred costs

(i) Deferred acquisition costs

The costs of acquiring new insurance contracts and participating investment contracts (excluding those assessed on a realistic basis - see note 36(1)(a)), which are incurred during a financial year but which relate to subsequent financial years, are deferred to the extent that they are recoverable out of future revenue margins. The deferred acquisition cost asset is amortised over the lifetime of the related contracts on a straight line basis.

The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written off where they are no longer considered to be recoverable.

(ii) Deferred origination costs

Costs which are directly attributable and incremental to securing new non-participating investment contracts are capitalised. This asset is subsequently amortised over the estimated contractual lifetime of each policy on a straight-line basis unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (r).

(k) Investment in subsidiaries

The Company owns a number of subsidiaries as set out in note 16. Certain subsidiaries do not form part of actively managed investment portfolios and the risks and rewards of owning those subsidiaries primarily rest with the shareholder of the Company, including such investments where ownership of the subsidiary is split between the Company's long-term fund and its shareholder fund. These subsidiaries are held initially at cost, being the fair value of the consideration given to acquire the holding, then subsequently at cost subject to impairment. Further information on the Group's impairment policy is set out at policy (r).

Certain subsidiaries, including holdings in collective investment vehicles, are held primarily as vehicles through which specific investments are held as part of the actively managed investment portfolios which are considered to be part of a business model that is managed and whose performance is evaluated on a fair value basis. Accordingly, such subsidiaries are carried at fair value and presented within investments at fair value through profit or loss in the Company (see policy p). Changes in their fair value are reflected in the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(l) Investment properties

Investment properties comprise freehold and long leasehold land and buildings, which are held either to earn rental income or for capital appreciation, or both, are initially measured at cost, being the fair value of the consideration given, including directly attributable transaction costs. Subsequently, on a periodic basis and at each reporting date, such properties are carried at fair value, being the open market value, as assessed by qualified external appraisers who have recent experience in the relevant location and the category of properties being valued. If this information is not available, alternative valuation methods such as discounted cash flow analysis or recent prices are used. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value.

Gains or losses arising from changes in the fair values of investment properties are recognised in the statement of comprehensive income in the period in which they arise, within net gains and losses on assets and liabilities at fair value through profit or loss.

Service charge income and expense are disclosed separately within the investment income and operating expense notes.

(m) Assets arising from reinsurance contracts held

The Group cedes reinsurance in the normal course of business. Where the reinsurance contract transfers significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the reinsurance contract does not transfer significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as a financial asset designated as fair value through profit or loss.

Assets arising from reinsurance contracts held – classified as insurance contracts

These assets are recognised within assets arising from reinsurance contracts held. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the underlying contracts and in accordance with the terms of each reinsurance contract. These balances are subject to an annual impairment review. Further information on the Group's impairment policy is set out at policy (r).

Changes in these assets are recognised on the face of the statement of comprehensive income, through change in assets arising from reinsurance contracts held.

Premiums ceded and claims reimbursed are recognised when corresponding insurance premium assumed and claims incurred. These items are disclosed separately on the face of the statement of comprehensive income.

Assets arising from reinsurance contracts held – at fair value through profit or loss

Amounts due from reinsurers in respect of contracts that do not transfer significant insurance risk to the reinsurer are measured as fair value through profit or loss as they are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis. These contracts, whilst legally reinsurance contracts, do not meet the definition of a reinsurance contract under IFRSs. Where this is the case, the amounts recoverable have been recognised as a financial asset within assets arising from reinsurance contracts held. Changes in these assets are recognised on the face of the statement of comprehensive income, through change in assets arising from reinsurance contracts held.

(n) Derivative financial instruments

Classification

Derivative financial instruments, including embedded derivatives, are held for trading, with the exception of derivatives which are designated as effective hedging instruments, which are held at fair value through profit or loss. Derivatives held for trading are used for the purposes of efficient portfolio management or to match contractual liabilities.

Recognition

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value.

Measurement

Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or other pricing models. Derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative.

Changes in the fair value of derivatives are recognised in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(n) Derivative financial instruments (continued)

Hedge accounting

In limited circumstances, derivatives are designated as fair value hedges. Hedge accounting allows one instrument, generally a derivative such as a swap, to be designated as a hedge of another instrument such as a loan.

Derivatives may only be designated as hedging instruments provided certain strict criteria are met. At the inception of a hedge, its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value of the hedged risk. The hedge documentation must also specify the methodology that will be used to measure effectiveness. Changes in the fair value of derivatives that are designated as fair value hedges are recorded in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The effectiveness of the hedging relationship must be tested throughout its life. A hedge is regarded as highly effective if the change in fair value of the hedge instrument and the hedge item are negatively correlated within a range of 80 per cent to 125 per cent, either for the period since effectiveness was last tested or for the period since inception. Where the hedge is highly effective, the net impact on the statement of comprehensive income is minimised. If, at a reporting date, it is concluded that the hedge is no longer highly effective in achieving its objective, the hedge relationship is terminated. Should this happen, changes in the fair value of the hedged item are no longer recognised in the statement of comprehensive income and the adjustment that has been made to the carrying amount of the hedged item is amortised to the statement of comprehensive income over the period to maturity of the hedged item.

Changes in the fair value of derivatives that qualify as a net investment hedge on foreign operations are taken to other comprehensive income when the hedge is deemed to be effective. The ineffective portion of any net investment hedge is recognised in the statement of comprehensive income immediately. The fair values of derivative instruments used for hedging purposes are disclosed in note 20.

All derivatives are presented as assets when their fair value is positive and as liabilities when their fair value is negative.

(o) Loans and receivables at amortised cost

Loans and receivables at amortised cost are financial assets, other than cash and cash equivalents that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest, a basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest.

Loans and receivables at amortised cost are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment. Further information on the Group's impairment policy is set out at policy (r).

(p) Investments at fair value through profit or loss

Investments at fair value through profit or loss comprise debt, equity securities, loans and advances to banks and loans and advances to customers.

Classification

Financial assets are classified at fair value through profit or loss where they are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis or they do not meet the criteria to be measured at amortised cost. All derivatives and equity instruments are carried at fair value through profit or loss.

Financial liabilities are measured at fair value through profit or loss where they are designated at fair value through profit or loss in order to reduce accounting mismatch or the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

Recognition

Purchases and sales of financial assets are recognised on the trade date, i.e. the date the Group commits to purchase the asset from, or deliver the asset to, the counterparty. Investments are initially recognised at cost, being the fair value of the consideration given, and are subsequently remeasured at fair value.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(p) Investments at fair value through profit or loss (continued)

Measurement

The fair values of investments are based on current bid prices. If the market for a financial asset is not active, and also for unlisted securities, the Group establishes fair value by using valuation techniques. These include the use of similar arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs. Refer to note 1(d) Fair value methodology and note 37(c) Financial risk management for details of valuation techniques and significant inputs to valuation models.

In order to ensure that a fair value is recognised for unquoted or illiquid debt securities, the primary price source is an external broker valuation.

Deposits with cedants represents funds withheld under the terms of the reinsurance agreement between the Company and the subsidiary undertaking SWE. Under that agreement the amount payable as premiums includes the investment incomes and gains earned by SWE on the funds withheld assets. The amount is remeasured to reflect the fair value of the underlying funds withheld assets.

Structured entities

The Group invests in structured entities arising from investments in investment properties held through limited partnerships. The unconsolidated limited partnerships are initially recognised at cost, being the fair value of the consideration given. After initial recognition, such assets are accounted for and measured at fair value, which equates to the relevant proportion of the published net asset value of the Company. This valuation is based on open market valuations of the properties held by the limited partnership, as provided at the reporting date by independent valuers.

The Group holds investments in structured entities arising from investments in collective investment vehicles, carried at fair value. Some of these structured entities are consolidated, as set out at policy (b). Unconsolidated collective investment vehicles are carried at fair value.

(q) Cash and cash equivalents

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

Cash and cash equivalents that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Cash and cash equivalents that are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis or do not meet the criteria to be measured at amortised cost are classified and measured as investments at fair value through profit or loss, as set out in policy (p).

(r) Impairment

Financial assets

The impairment charge in the statement of comprehensive income includes the change in expected credit losses for financial assets held at amortised cost and certain lease receivables. Expected credit losses are calculated by using an appropriate probability of default and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held or other mitigants of loss.

At initial recognition, allowance is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk, allowance is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(r) Impairment (continued)

Financial assets (continued)

For financial instruments that are considered to have low credit risk, the credit risk is assumed to not have increased significantly since initial recognition. Financial instruments are considered to have low credit risk when the borrower is considered to have a low risk of default from a market perspective. Typically financial instruments with an external credit rating of investment grade are considered to have low credit risk.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop.

The loss allowance for lease receivables and trade receivables without a significant financing component is measured at an amount equal to lifetime expected credit losses, in accordance with the simplified approach in IFRS 9.

A loan or receivable is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

Non-financial assets

Assets that have an indefinite useful life, for example land, are not subject to depreciation or amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs. Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(s) Taxes

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

Current tax

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or other relevant tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

Deferred tax

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(s) Taxes (continued)

Deferred tax (continued)

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

Allocation of tax charge between shareholder and policyholders

The tax expense in the statement of comprehensive income is analysed between policyholder and shareholder tax. This allocation is based on the definition of policyholders' share and shareholders' share of taxable profit under current UK tax rules.

(t) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Dividends payable

Dividends payable on ordinary shares are recognised in equity in the period in which they are approved.

(u) Insurance contracts and participating investment contracts

The Group issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income and also issues pension and annuity contracts. Guaranteed claims paid on occurrence of the specified insured event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

Insurance contracts or participating investment contracts in the Group’s With Profits Funds

Liabilities of the Group’s With Profits Funds, including guarantees and options embedded within products written by the funds, are accounted for under the realistic method in accordance with a pre-Solvency II traditional regulatory assessment, grandfathered under IFRS 4 'Insurance Contracts'. Projected transfers out of the funds into other funds of the Group are not treated as insurance liabilities, but are recorded in unallocated surplus. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change in liabilities in insurance contracts and participating investment contract liabilities.

Liabilities for non-participating insurance contracts in the Group's With Profits Funds are measured using an assessment that uses the pre Solvency II traditional regulatory assessment. In addition, the realistic value of future profits on those contracts is recognised as an offset to the corresponding liabilities in the balance sheet, as future profits on non-participating business in the With Profits Funds. The movement in this balance is recognised in the statement of comprehensive income, through change in liabilities arising from insurance contracts and participating investment contracts.

Insurance contracts which are neither unit-linked nor in the Group’s With Profits Funds

The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date, allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change arising from insurance contracts and participating investment contract liabilities.

Insurance contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either insurance contracts or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. Non-unit reserves are also established for expected future expenses not covered by future margins, inadequacy of benefit charges to cover benefit claims, and inadequacy of guarantee charges to cover guarantees. Income consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through changes in liabilities arising from insurance contracts and participating investment contracts. Benefit claims in excess of the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through gross claims and benefits paid.

Unallocated surplus

Any amounts in the With Profits Funds not yet determined as being due to policyholders or the equity holder and projected transfers out of the funds to other funds of the Group are recognised as an unallocated surplus which is shown separately from the other insurance liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(u) Insurance contracts and participating investment contracts (continued)

Inwards reinsurance

Liabilities arising where the Group, acting as a reinsurer, accepts inward reinsurance are included within insurance and participating investment contract liabilities.

Bonuses

Bonuses in a given year comprise:

- Unit price increases and new reversionary bonuses declared in respect of that year which are provided within the calculation of liabilities arising from insurance and participating investment contracts; and
- Terminal and interim bonuses paid out to policyholders on maturity and included within gross claims and benefits paid

Lifetime Mortgages

The lifetime mortgages held within a special purpose vehicle provide a no-negative equity guarantee which meets the definition of an insurance contract. The guarantee is embedded in the mortgage and included within the mortgage valuation; it is accounted for in accordance with IFRS 4 'Insurance Contracts' and is not unbundled or disclosed separately. The lifetime mortgages are classified within a business model in line with policy (c) and held at fair value through profit or loss.

(v) Provisions for other liabilities and charges

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from contracts are less than the unavoidable costs of meeting the obligations under the contracts.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless the likelihood of possible obligations arising is remote.

(w) Subordinated debt

Subordinated debt comprises dated and undated loan capital. They are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. Subordinated debt is subsequently stated at amortised cost: any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income through finance costs over the period of the liabilities using the effective interest rate applicable to the instrument. Both dated and undated subordinated debt is adjusted for hedged interest rate risk. Changes in the resulting value of this subordinated debt is accounted for as set out at policy (p). Interest payable is recognised in the statement of comprehensive income, through finance costs.

The subordinated guaranteed bonds are classified as a liability on the basis of the existence of a capital disqualification event considered to be a genuine settlement provision in the context of current uncertainty surrounding the direction of future regulatory rule developments.

(x) Non-participating investment contracts

The Group’s non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group’s unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the reporting date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment income allocated to non-participating investment contracts is presented within investment income, with corresponding movements being included in change in non-participating investment contract liabilities.

Deposits and withdrawals are not accounted for through the statement of comprehensive income but are accounted for directly in the balance sheet as adjustments to the liability arising from non-participating investment contracts.

Fee and commission income in relation to non-participating unit linked investment business is presented within the statement of comprehensive income within fee and commission income.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

1. Accounting policies (continued)

(y) Liability adequacy test

At each reporting date, liability adequacy tests are performed to ensure the adequacy of the insurance contracts and participating investment contract liabilities net of related deferred costs and acquired VIF. In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the statement of comprehensive income, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from the liability adequacy tests.

(z) Other financial liabilities

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

(aa) External interests in collective investment vehicles

External interests in collective investment vehicles which are accounted for by the Group as investments in subsidiaries as set out at policy (k) above are initially recognised, and subsequently measured at amortised cost. Due to the nature of these balances, the carrying value equates to the fair value. The fair value of holdings in these funds is determined at the valuation point applicable to the collective investment vehicles at the reporting date as set out under policy (p) above. Changes in the value of this balance are recognised in the statement of comprehensive income, through net profit attributable to external interests in collective investment vehicles.

(ab) Borrowings

Borrowings are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. In practice, due to the nature of these balances, being bank overdrafts, the carrying value equates to the fair value of these liabilities as the borrowings are repayable on demand.

(ac) Foreign currency translation

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in pounds sterling, rounded to the nearest million, which is the Company’s presentation and functional currency.

Monetary items denominated in foreign currencies are translated into sterling at the exchange rates ruling at the reporting date. Non-monetary items denominated in foreign currencies that are measured at fair value are translated at the exchange rates ruling at the date when the current fair value is determined. Non-monetary items denominated in foreign currencies that are measured at historical cost are translated at the exchange rates ruling at the date of the transaction. Revenue transactions and those relating to the acquisition and realisation of investments have been translated at rates of exchange ruling at the time of the respective transactions. Any exchange differences are dealt with in that part of the statement of comprehensive income in which the underlying transaction is reported.

The results and financial position of the Group's foreign operations that have a functional currency different from the presentational currency are translated into sterling at foreign exchange rates ruling at the balance sheet date.

The income and expenses of foreign operations are translated into sterling at average exchange rates, unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions. Foreign exchange differences arising on the translation of foreign operations are recognised in other comprehensive income.

(ad) Collateral

The Group receives or pledges collateral in the form of cash or securities in respect of derivative transactions it undertakes. The Group also receives collateral in the form of securities in respect of stock lending agreements, repurchase agreements, certain loans made to related parties and bulk annuity contracts. Cash collateral received is recognised as an asset on the balance sheet. Non-cash collateral is recognised as an asset on the balance sheet when the Group has the right to sell or repledge the collateral and when the transferor has defaulted. A corresponding liability for repayment of collateral is recognised in financial liabilities. Collateral received that is not recognised on the balance sheet is legally segregated from the assets of the Group. Cash collateral pledged is derecognised from the balance sheet and a corresponding asset is recognised. Non-cash collateral continues to be recognised on the balance sheet as the Group retains the risks and rewards of ownership.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

2. Critical accounting judgments and estimates

The Group's management makes estimates and judgments that affect the reported amount of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Critical accounting estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

a. Insurance contracts and participating investment contract liabilities

The estimation of the ultimate liability arising from insurance contracts and participating investment contracts which are not unit-linked is the Group's most critical accounting estimate.

The liabilities of the Group's With Profits Funds are calculated using stochastic simulation models which value liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The liabilities are sensitive to both investment market conditions and changes to a number of non-economic assumptions, such as the level of take-up of options inherent in the contracts, mortality rates and lapses prior to dates at which a guarantee would apply.

For insurance contracts outside the With Profits Funds, the liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses, credit default and mortality. Discount rates used to value the liabilities for annuity business are set with reference to the risk-adjusted yields on the underlying assets and for non-annuity business with reference to cash yields. The most critical non-economic assumptions are mortality rates in respect of annuity business written and levels of future expenses.

Such assumptions are based on recent actual experience, supplemented by industry information where appropriate. No critical accounting estimates apply for participating investment contracts as the contract liabilities arising outside of the With Profits Funds are almost entirely current unit values.

At each reporting date, the estimates and assumptions referred to above are reassessed for adequacy and changes will be reflected in adjustments to the liability, through the statement of comprehensive income. Further information on these assumptions is given in note 36.

b. Deferred costs

For insurance contracts and participating investment contracts (excluding those assessed on a realistic basis - see note 36(1)(a)) acquisition costs which are incurred during a financial year but which relate to subsequent financial years are deferred to the extent that they are recoverable out of future revenue margins. All other costs are recognised as expenses when incurred. The calculation of the deferred acquisition cost asset and its pattern of amortisation requires estimation of both the expected pattern of receipt of future revenue margins and the period that the business is expected to remain in-force. Further information on this asset is given in note 14.

The recognition of costs and income in respect of non-participating investment contracts is governed by IFRS 15 'Revenue from Contracts with Customers'. Under this standard, directly attributable and incremental costs to securing new business are capitalised and are then subsequently amortised over the period of the provision of the investment management services. Estimation is required of the period that the business is expected to remain in-force and prudent assumptions are required for contracts which do not have a fixed maturity date.

c. Fair value of financial instruments

In accordance with IFRS 7, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as Level 1 are valued using quoted market prices and therefore there is minimal judgment applied in determining fair value. However, the fair value of financial instruments categorised as Level 2 and, in particular, Level 3 is determined using valuation techniques. These valuation techniques involve management judgment and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. Further details of these valuations are described in note 37.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

2. Critical accounting judgments and estimates (continued)

d. Provisions for other liabilities and charges

The Group continues to receive claims in Germany from customers relating to policies issued by the Company, under its former name of Clerical Medical Investment Group Limited but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s.

The German industry-wide issue regarding notification of contractual ‘cooling off’ periods has continued to lead to a steady flow of claims throughout 2019 and 2020. Whilst complaint volumes continued to decline during 2020, new litigation claim volumes per month have remained fairly constant. The total provision made to 31 December 2020 is £674 million (2019: £656 million; utilisation has increased to £28 million in the year ended 31 December 2020 (2019: £28 million); the remaining unutilised provision as at 31 December 2020 is £91m (2019: £101 million).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

The Directors believe this provision represents an appropriate estimate of the financial impact based upon a series of assumptions, including the number of claims received from the respective populations of different classes of policies, the proportion upheld, and resulting legal and administration costs. Further information in relation to the provision is set out in note 28.

Critical judgments

The Directors also use judgment in the process of applying the Group’s accounting policies. The following judgments have the most significant effect on the amounts recognised in the consolidated financial statements.

e. Taxation

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised. Deferred tax assets are offset against deferred tax liabilities on the balance sheet.

With regard to the Group’s and Company’s deferred tax assets, a significant feature is the management judgment applied in determining the timing, sensitivities and probability of them crystallising. This judgment is based on tax forecasts reflecting new business assumptions, sensitivities and proposed management actions. Further information in relation to the Group’s and Company’s deferred tax assets is set out in notes 12 and 15.

f. Assessment of significant insurance risk

Insurance contracts are those contracts which transfer significant insurance risk. As a general guideline, the Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. Management judgement is required in assessing whether contracts transfer significant insurance risk to determine whether the contract is accounted for under IFRS 4. Further information about the Group’s insurance contract liabilities is set out in notes 25 and 36.

g. Investment vehicles

The Group consolidates investment vehicles when it has control and is therefore acting as a principal rather than an agent. Control typically arises were the Group has the power to determine investment activities of the fund and also has exposure to significant variable returns. Variable returns are assessed together with other relevant factors in accordance with the guidance in IFRS 10, such as the fund structure and remuneration of the decision maker. Control can arise when the Group has less than a majority beneficial interest. The Group’s holdings in these investment funds can fluctuate over time. The Group has established a set of principles covering the percentage ownership of investment funds, approach to consolidation where ownership share varies and nature of the returns from the funds, which are considered together at each reporting date to allow judgement to be applied as to whether the Group is acting as a principal or agent.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

3. Segmental analysis

In the opinion of the Directors, the Group operates in a single business segment, being the provision of long-term insurance and investment contracts, and therefore the following specific disclosure requirements under IFRS 8 'Operating Segments' are required. The table below provides a summary of the gross premiums written within the single business segment:

Group	**2020**	**2019**
	£m	**£m**
Regular premiums	5,127	4,596
Single premiums	3,078	4,724
Total	8,205	9,320

Further, a summary of the gross premiums written by the segment's main product types is shown below:

Group	**2020**	**2019**
	£m	**£m**
Bulk Annuities	989	2,042
Corporate pensions	4,859	4,645
Individual pensions	408	424
Retirement income	496	486
Protection	396	476
Investments	128	180
Retirement account	929	1,067
Total	8,205	9,320

Of the above gross written premiums, £90 million (2019: £83 million) relates to the European business with the remaining written in the UK.

4. Fee and commission income

Group	**2020**	**2019**
	£m	**£m**
Fund management and policy administration fees	191	223
Change in deferred income	5	9
Other	1	—
Total	197	232

5. Investment income

Group	**2020**	**2019**
	£m	**£m**
Net income on investments at fair value through profit or loss	3,002	3,859
Interest income on Lloyds Banking Group loans	14	38
Rental income on investment properties	191	191
Service charge income	13	14
Other	10	13
Total	3,230	4,115

6. Net gain on assets and liabilities at fair value through profit or loss

Group	**2020**	**2019**
	£m	**£m**
Derivative financial instruments at fair value through profit or loss	421	(79)
Investments at fair value through profit or loss	1,499	11,801
Investment properties at fair value through profit or loss	(188)	(109)
Fair value hedge adjustment in respect of swap	(102)	(73)
Foreign exchange	30	(15)
Total	1,660	11,525

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

7. Gain on transfer of business

In 2019, Scottish Widows Unit Trust Managers Limited transferred the management of £12 billion of wealth related assets to a related undertaking, Scottish Widows Schroder Personal Wealth ACD Limited. Consideration of £192 million was recognised as a gain on the transfer of this business.

Group	**2020**	**2019**
	£m	**£m**
Consideration received	—	192
Total	—	192

8. Other operating income

Group	**2020**	**2019**
	£m	**£m**
External rebates	86	95
Other	11	85
Total	97	180

9. Operating expenses

Group	**2020**	**2019**
	£m	**£m**
Acquisition and origination costs in respect of insurance and investment contracts	113	114
Expenses for administration	837	953
	950	1,067
Fees and commissions payable	26	26
Change in deferred costs	—	17
Service charge expense	16	16
Amortisation of acquired VIF	6	13
Other	46	63
Total	1,044	1,202

10. Auditors' remuneration

Group	**2020**	**2019**
	£000	**£000**
Fees payable to the Group's auditors for the audit of the Company's annual financial statements and the consolidation	2,855	2,880
Fees payable to the Group's auditor and its associates for other services:		
Audit of subsidiaries	1,222	1,092
Audit-related assurance services	938	916
Non-Audit Services	—	160
Total fees payable	5,015	5,048

11. Finance costs

Group	**2020**	**2019**
	£m	**£m**
Interest on swaps	(27)	(21)
Interest on subordinated debt	91	96
Other	11	10
Total	75	85

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

12. Taxation (credit)/charge

(a) Current year tax (credit)/charge

Group	2020 £m	2019 £m
Current tax:		
UK corporation tax	35	36
Overseas Tax	2	1
Adjustment in respect of prior years	(18)	(3)
Total current tax	19	34
Deferred tax:		
Reversal of temporary differences	(154)	56
Change in tax rate	26	(2)
Adjustment in respect of prior years	9	2
Total deferred tax	(119)	56
Total income tax (credit)/charge	(100)	90

The policyholder tax benefit or expense is included in the income tax (credit)/charge. Policyholder tax is a credit of £(31) million (2019: charge of £189 million), including a prior year tax charge of nil (2019: charge of nil)

(b) Reconciliation of tax (credit)/charge

Group	2020 £m	2019 £m
(Loss)/Profit before tax	(296)	69
Tax at 19% (2019: 19%)	(56)	13
Effects of:		
Non-taxable income	(44)	(51)
Policyholder tax	(25)	153
Adjustment in respect of prior years	(9)	(2)
Disallowable expenses	4	13
Change in tax rate	26	(2)
Non-taxable gain on transfer	—	(36)
Overseas tax	4	—
Other	—	2
Total	(100)	90

As a result of legislation introduced in 2016, the UK corporation tax rate was due to reduce from 19 per cent to 17 per cent with effect from 1 April 2020. However, the UK government maintained the rate at 19 per cent for the financial year 2020 within the Finance Bill 2020. The effect of this change resulting in a £26 million increase in deferred tax liability, has been reflected in the above table.

On 3 March 2021, the UK government announced its intention to increase the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. Had this change in corporation tax been enacted on 31 December 2020, the impact would have been to increase net deferred tax liabilities by approximately £29 million.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

13. Intangible assets including insurance intangible assets

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Acquired VIF	55	49	61	55
Goodwill	15	10	15	10
Software development costs	30	—	26	—
Total	100	59	102	65

The recoverable amount of the goodwill relating to the Workplace Savings business has been based on a value-in-use calculation. The calculation uses pre-tax projections of future cash flows based upon budgets and plans approved by management covering a three-year period, the related run-off of existing business in-force and a discount rate of 10 per cent. The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. New business cash flows beyond the three-year period have been extrapolated using a steady 2 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of goodwill to fall below its balance sheet carrying value.

Group	2020				2019			
	Acquired VIF	Goodwill	Software development costs	Total	Acquired VIF	Goodwill	Software development costs	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cost								
At 1 January	663	15	31	709	657	5	27	689
Additions	—	—	8	8	6	10	4	20
At 31 December	663	15	39	717	663	15	31	709
Accumulated amortisation and impairment								
At 1 January	(602)	—	(5)	(607)	(589)	—	(2)	(591)
Amortisation during the year	(6)	—	(4)	(10)	(13)	—	(3)	(16)
At 31 December	(608)	—	(9)	(617)	(602)	—	(5)	(607)
Carrying amount								
At 31 December	55	15	30	100	61	15	26	102

Company	2020			2019		
	Acquired VIF	Goodwill	Total	Acquired VIF	Goodwill	Total
	£m	£m	£m	£m	£m	£m
Cost						
At 1 January	657	10	667	651	—	651
Additions	—	—	—	6	10	16
At 31 December	657	10	667	657	10	667
Accumulated amortisation and impairment						
At 1 January	(602)	—	(602)	(589)	—	(589)
Amortisation during the year	(6)	—	(6)	(13)	—	(13)
At 31 December	(608)	—	(608)	(602)	—	(602)
Carrying amount						
At 31 December	49	10	59	55	10	65

The additions to intangible assets in 2019 arose from the Zurich Part VII Transfer Scheme.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

13. Intangible assets including insurance intangible assets (continued)

The additions to software development costs in 2020 arise from additional enhancements to the Corporate Saving Platform by SWAS during the year.

Of the above total for acquired VIF, £44 million (2019: £44 million) is expected to be recovered more than one-year after the reporting date. The remaining amortisation period is 7 years (2019: 8 years) for £44 million of the acquired VIF and 17 years (2019: 18 years) for £5 million of the acquired VIF.

14. Deferred costs

		2020		2019	
		£m	£m	£m	£m
		Group	Company	Group	Company
Deferred acquisition costs	(a)	1,550	1,550	1,531	1,531
Deferred origination costs	(b)	85	78	104	94
Total		1,635	1,628	1,635	1,625

(a) Deferred acquisition costs

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
At 1 January	1,531	1,531	1,515	1,515
Amounts incurred during the year	160	160	186	186
Amortisation during the year	(169)	(169)	(160)	(160)
Changes to impairment of deferred costs	28	28	(10)	(10)
At 31 December	1,550	1,550	1,531	1,531

Of the above total, £1,375 million for Group and Company (2019: £1,389 million for Group and Company) is expected to be recovered more than one-year after the reporting date.

(b) Deferred origination costs

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
At 1 January	104	94	137	122
Amounts incurred during the year	—	—	2	—
Amortisation during the year	(19)	(16)	(35)	(28)
At 31 December	85	78	104	94

Of the above total, £74 million for Group and £69 million for Company (2019: £91 million for Group and £83 million for Company) is expected to be recovered more than one-year after the reporting date.

15. Tax assets and liabilities

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Current tax recoverable	123	116	50	41
Total tax assets	123	116	50	41
Deferred tax liabilities	147	155	266	265
Total tax liabilities	147	155	266	265

The Group has made claims to recover historic UK taxes paid on overseas dividends. These claims may result in recovery of a material amount of taxes previously paid by the Company and the OEICs it consolidates, though the benefit of these claims remains uncertain pending ongoing litigation and other uncertainties.

HMRC issued a briefing note in January 2020 on their intended approach to settling some of these claims. The tax assets recognised in these accounts reflect the Group's view of the impact of this guidance.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

15. Tax assets and liabilities (continued)

a. Recognised deferred tax

Deferred tax assets and liabilities have been offset in the balance sheet where there is a legally enforceable right of offset. The tables below split the individual deferred tax assets and liabilities by type, before such netting.

The amounts are as follows:

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Deferred tax assets comprise:				
Expenses deductible in future periods	124	124	120	120
Trading losses	9	—	—	—
Accelerated capital allowances	—	—	—	—
Total deferred tax assets	133	124	120	120
Deferred tax liabilities comprise:				
Unrealised gains on investment assets	58	58	142	142
Deferred acquisition costs	123	123	125	125
Transitional adjustments on introduction of new life tax regime	87	87	110	110
Deferred tax on acquired VIF	9	8	9	8
Other	3	3	—	—
Total deferred tax liabilities	280	279	386	385
Net deferred tax liabilities	147	155	266	265

Deferred tax assets for trading losses, expenses deductible in future periods and accelerated capital losses are recognised on the basis of future profit projections, which show sufficient future taxable profits to utilise these assets. Of the deferred tax assets included in the above table, nil for Group and Company (2019: nil for Group and Company) is expected to be realised within one-year of the reporting date.

Of the deferred tax liabilities included in the above table, £60 million for Group and Company (2019: £63 million for Group and Company) is expected to be settled within one-year of the reporting date.

Of the deferred tax assets and liabilities balances shown in the above table, £44 million for Group and Company (2019: £70 million for Group and Company), relating to ‘transitional adjustments on introduction of new life tax regime' are expected to be settled more than one-year after the reporting date.

As a result of legislation introduced in 2016, the UK corporation tax rate was due to reduce from 19 per cent to 17 per cent with effect from 1 April 2020. However, the UK government maintained the rate at 19 per cent for the financial year 2020 within the Finance Bill 2020. The effect of this change resulting in a £26 million increase in deferred tax liability, has been reflected in the above table.

On 3 March 2021, the UK government announced its intention to increase the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. Had this change in corporation tax been enacted on 31 December 2020, the impact would have been to increase net deferred tax liabilities by approximately £29 million.

The tax charge/(credit) in the statement of comprehensive income relating to each item is as follows:

	2020	2019
	£m	£m
	Group	Group
Trading losses	(9)	—
Expenses deductible in future periods	(4)	(13)
Accelerated capital allowances	—	2
Unrealised gains/losses on investment assets	(84)	133
Deferred acquisition costs	(2)	(22)
Transitional adjustments on introduction of new life tax regime	(23)	(41)
Deferred tax on acquired VIF	—	(2)
Other	3	(1)
Total deferred tax charge/(credit)	(119)	56

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

15. Tax assets and liabilities (continued)

b. Unrecognised deferred tax

Deferred tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable. The UK deferred tax assets not recognised are not subject to any expiry date and the Luxembourg trading losses are subject to 17 years limit.

Deferred tax assets have not been recognised in respect of excess expenses carried forward (£115 million (2019: £44 million)) and in respect of trading losses (£6 million) in SWE, as there is insufficient certainty as to the availability of future profits.

16. Investment in subsidiaries

Company	**2020** **£m**	**2019** **£m**
At 1 January	624	467
Impairment of investment in subsidiaries	(233)	—
Investment in subsidiary	72	157
At 31 December	463	624

During the year, Scottish Widows Unit Trust Managers Limited (SWUTM) paid a dividend from the proceeds of the transfer of wealth related assets in 2019 (see note 7). To reflect the long-term value of the subsidiary following the transfer, the Company has impaired the carrying value of SWUTM to its recoverable amount of £147 million. This has been determined as equal to its fair value less costs of disposal, calculated considering the fair valuations from price-equity, earnings before interest, taxes, depreciation and amortisation, and price-assets under management models, and utilising a liquidity discount of 25% and run off rate of 13% as key assumptions. As these assumptions are not based on observable market inputs, the fair value measurement of this asset is categorised within fair value hierarchy Level 3.

In the prior year, as part of the transfer process described in note 42, SWE issued £5 million (€6 million) of ordinary share capital to the Company. Further share premium of £152 million (€175 million) was issued during the year following the transfer process.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

16. Investment in subsidiaries (continued)

All entities detailed below are wholly-owned, directly or indirectly, and transact insurance or reinsurance business, investment management activities or services in connection therewith, unless otherwise stated. Following are particulars of the Company's subsidiaries and associates:

Celsius European Lux 2 SARL	(3)	Scottish Widows Administration Services Limited	(13)
Clerical Medical Non Sterling Property Company SARL	(3)	Scottish Widows Administration Services (Nominees) Limited	(14)
Clerical Medical Non Sterling Guadalix Holdco BV	(4)	Scottish Widows Auto Enrolment Services Limited	(13)
Clerical Medical Non Sterling Guadalix Spanish Propco SL	(5)	Scottish Widows Europe S.A.	(19)
Clerical Medical Non Sterling Megapark Holdco BV	(4)	Scottish Widows Fund and Life Assurance Society	(14)
Clerical Medical Non Sterling Megapark Propco SA	(5)	Scottish Widows Industrial Properties Europe BV	(15)
CM Venture Investments Limited	(6)	Scottish Widows Property Management Limited	(14)
Dalkeith Corporation LLC	(7)	Scottish Widows Trustees Limited	(14)
Delancey Arnold UK Limited (50%)*	(8)	Scottish Widows Unit Trust Managers Limited	(17)
Delancey Rolls UK Limited (50%)*	(8)	St Andrew's Life Assurance plc	(2)
France Industrial Premises Holding	(9)	Saint Michel Holding Company No 1	(9)
General Reversionary and Investment Company (80%)	(2)	Saint Michel Investment Property	(9)
The Great Wigmore Partnership (G.P.) Limited (50%)	(10)	Saint Witz II Holding Company No 1	(9)
Great Wigmore Property Limited (50%)	(10)	Saint Witz II Investment Property	(9)
Halifax Life Limited	(11)	SWAMF (GP) Limited**	(1)
Rolls Development UK Limited (50%)*	(8)	SWAMF Nominee (1) Limited**	(1)
SARL Coliseum	(12)	SW No 1 Limited	(16)
SARL HIRAM	(12)	Thistle Investments (AMC) Limited	(18)
SAS Compagnie Fonciere de France	(12)	Thistle Investments (ERM) Limited	(18)
SCI Astoria Invest	(12)	Waverley Fund II Investor LLC	(7)
SCI de l'Horloge	(12)	Waverley Fund III Investor LLC	(7)
SCI Equinoxe	(12)		
SCI Rambeateau CFF	(12)		

* In liquidation

** Dissolved January 2021

The investments in subsidiaries included above are generally recoverable more than one-year after the reporting date.

The ability of regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by regulatory solvency requirements as well as Companies Act distributable reserves requirements. The ability of non-regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by Companies Act distributable reserves requirements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

16. Investment in subsidiaries (continued)

Registered office addresses

(1) Ernst & Young 1 More London Place, London, SE1 2AF
(2) 33 Old Broad Street, London, EC2N 1HZ
(3) Citco REIF Services, 20 Rue de Poste, L-2346, Luxembourg
(4) Naritaweg 165, 1043 BW, Amsterdam, Netherlands
(5) Calle Pinar 7, 50Izquierda, 28006, Madrid, Spain
(6) RL360 House, Cooil Road, Douglas, Isle of Man, IM2 2SP
(7) Corporation Service Company, 251 Little Falls Drive, Wilmington, DE 19805, United States
(8) 4th Floor 4 Victoria Street, St. Albans, Hertfordshire, AL1 3TF
(9) SAB Formalities, 23 Rue de Roule, Paris, 75001, France
(10) 33 Cavendish Square, London, WIG 0PW
(11) Trinity Road, Halifax, West Yorkshire, HX1 2RG
(12) 8 Avenue Hoche, 75008, Paris, France
(13) 25 Gresham Street, London, EC2V 7HN
(14) 69 Morrison Street, Edinburgh, EH3 8BW
(15) Weena 340, 3012 NJ, Rotterdam, Netherlands
(16) Port Hamilton, 69 Morrison Street, Edinburgh, EH3 8YF
(17) Charlton Place, Andover, Hampshire, SP10 1RE
(18) 1 Bartholomew Lane, London, EC2N 2AX
(19) 1, Avenue du Bois, L-1251, Luxembourg

Collective investment vehicles and limited partnerships ('investment vehicles') where the Group has control, in part through its long-term funds, are consolidated as set out in policy 1(b).

The table overleaf lists collective investment vehicles and limited partnerships which are considered to be related undertakings due to the Group holding of 20 per cent or more.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

16. Investment in subsidiaries (continued)

Name Of Umbrella And Undertaking	% Held
HBOS International Investment Funds ICVC (i)	
North American Fund	95.26%
Far Eastern Fund	80.45%
European Fund	93.42%
International Growth Fund	52.44%
Japanese Fund	94.72%
HBOS Specialised Investment Funds ICVC (i)	
Cautious Managed Fund	51.68%
Ethical Fund	81.73%
Fund Of Investment Trusts	40.08%
Smaller Companies Fund	65.10%
Special Situations Fund	50.41%
HBOS UK Investment Funds ICVC (i)	
UK Equity Income Fund	61.53%
UK Growth Fund	62.92%
UK FTSE All-Share Index Tracking Fund	56.88%
HBOS Actively Managed Portfolio Funds ICVC (i)	
Diversified Return Fund	94.22%
Absolute Return Fund	94.59%
Dynamic Return Fund	96.62%
HBOS Property Investment Funds ICVC (i)	
UK Property Fund	50.07%
Scottish Widows Tracker And Specialist Investment Funds ICVC (ii)	
UK All Share Tracker Fund	91.06%
UK Tracker Fund	45.74%
UK Fixed Interest Tracker Fund	96.49%
Emerging Markets Fund	87.89%
UK Index-Linked Tracker Fund	39.08%
UK Smaller Companies Fund	20.27%
Scottish Widows UK And Income Investment Funds ICVC (ii)	
UK Growth Fund	62.36%
Environmental Investor Fund	73.54%
Ethical Fund	80.07%
Scottish Widows Overseas Growth Investment Funds ICVC (ii)	
Global Growth Fund	55.13%
European Growth Fund	89.00%
American Growth Fund	83.51%
Pacific Growth Fund	75.29%
Japan Growth Fund	93.23%
Scottish Widows Managed Investment Funds ICVC (ii)	
International Equity Tracker Fund	80.95%
Balanced Portfolio Fund	82.72%
Progressive Portfolio Fund	72.11%

Name Of Umbrella And Undertaking	% Held
Cautious Portfolio Fund	61.79%
Cash Fund	98.94%
Opportunities Portfolio Fund	91.60%
Multi-Manager ICVC (xiii)	
Multi Manager UK Equity Income Fund	39.42%
Multi Manager UK Equity Growth Fund	83.73%
Scottish Widows Investment Solutions Funds ICVC (ii)	
European (Ex UK) Equity Fund	95.99%
Asia Pacific (Ex Japan) Equity Fund	98.63%
Japan Equities Fund	88.67%
US Equities Fund	100.00%
Fundamental Index UK Equity Fund	86.44%
Fundamental Index Global Equity Fund	95.61%
Fundamental Index Emerging Markets Equity Fund	95.11%
Fundamental Low Volatility Index Global Equity Fund	98.13%
Fundamental Low Volatility Index Emerging Markets Equity Fund	95.24%
Fundamental Low Volatility Index UK Equity Fund	91.30%
Scottish Widows High Income Bond Fund	28.92%
Scottish Widows International Bond Fund	69.82%
Scottish Widows Corporate Bond Fund	67.34%
Scottish Widows Gilt Fund	96.14%
Scottish Widows Strategic Income Fund	64.53%
Scottish Widows Income And Growth Funds ICVC (ii)	
Balanced Growth Fund	30.95%
Progressive Growth Fund	46.94%
UK Index Linked Gilt Fund	100.00%
Corporate Bond PPF Fund	100.00%
SW Corporate Bond Tracker	100.00%
Scottish Widows GTAA 1	83.54%
Corporate Bond 1 Fund	96.10%
Adventurous Growth Fund	44.62%
ACS Pooled Property (ii)	
Scottish Widows Pooled Property ACS Fund	99.85%
Scottish Widows Pooled Property ACS Fund 2	99.75%
Investment Portfolio ICVC (xiii)	
IPS Income Portfolio	24.99%
IPS Growth Portfolio	28.33%
Aberdeen Liquidity Fund (Lux) (iv)	
Aberdeen Liquidity Fund (Lux) – Ultra Short Duration Sterling Fund	70.43%
SSGA Europe (Ex UK) (xv)	
SSGA Europe (ex UK)	95.98%
SSGA Asia Pacific Tracker Fund (xv)	
SSGA Asia Pacific Tracker Fund	93.66%

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

16. Investment in subsidiaries (continued)

Name Of Umbrella And Undertaking	% Held
Universe, The CMI Global Network (iii)	
CMIG GA 70 Flexible	100.00%
CMIG GA 80 Flexible	100.00%
CMIG GA 90 Flexible	100.00%
European Enhanced Equity	100.00%
CMIG Access 80%	100.00%
Continental Euro Equity	97.39%
UK Equity	77.55%
US Enhanced Equity	86.92%
Japan Enhanced Equity	93.17%
Pacific Enhanced Basin	79.33%
Euro Bond	59.66%
US Bond	94.14%
US Currency Reserve	75.98%
Euro Currency Reserve	98.63%
US Tracker	28.92%
CMIG Focus Euro Bond	99.93%
Euro Cautious	89.14%
BNY Mellon Managed Funds II (vi)	
Insight Absolute Fund of Funds	84.02%
Schroder Funds ICAV (xxv)	
Schroder Sterling Liquidity Fund	71.26%
Schroder Sterling Short Duration Bond Fund	91.37%
Artemis Institutional Funds (xxiii)	
Artemis Institutional Global Capital Fund	43.67%
Baillie Gifford Investment Funds ICVC (xxi)	
Baillie Gifford Multi Asset Growth Fund	23.10%
BNY Mellon Investment Funds (vi)	
BNY Mellon US Opportunities Fund	38.85%
Insight Global Multi-Strategy Fund	42.37%
Newton Uk Opportunities Fund	52.95%
Insight Global Absolute Return Fund	77.48%
BNY Mellon Global Balanced Fund	20.64%
Newton UK Income Fund	27.65%
BNY Mellon Global Equity Fund	25.41%
Newton Multi-Asset Growth Fund	25.43%
Retail Authorised Unit Trusts (xvi)	
Blackrock Balanced Growth Portfolio Fund	36.73%
BlackRock Fixed Income Dublin Funds (xvii)	
iShares Emerging Markets Local Government Bond Index Fund (IE)	70.52%
iShares Emerging Markets Government Bond Index Fund (IE)	44.04%

Name Of Umbrella And Undertaking	% Held
BlackRock Authorised Contractual Scheme I (xi)	
BlackRock ACS Japan Equity Tracker Fund	76.85%
BlackRock ACS UK Equity Tracker Fund	91.87%
BlackRock ACS US Equity Tracker Fund	77.18%
ACS World Multifactor Equity Tracker Fund	45.12%
ACS Climate Transition World Equity Fund	68.79%
BlackRock Collective Investment Funds (xvi)	
iShares Global Property Securities Equity Index Fund	39.47%
Fidelity Active Strategy (xx)	
FAST - UK Fund	29.52%
HLE Active Managed Portfolio Konservativ (xviii)	36.25%
HLE Active Managed Portfolio Dynamisch (xviii)	37.37%
HLE Active Managed Portfolio Ausgewogen (xviii)	48.09%
Invesco Perpetual Asian Equity Income Fund (viii)	26.50%
Lazard Developing Markets Fund (xxii)	90.17%
MGI Funds plc (vii)	
Mercer Multi Asset Defensive Fund	58.01%
Mercer Multi Asset Moderate Growth Fund	82.02%
Mercer Multi Asset High Growth Fund	80.19%
Mercer Diversified Retirement Fund	69.42%
Mercer Multi Asset Growth Fund	64.05%
The TM Levitas Funds (xii)	
TM Levitas A Fund	52.60%
TM Levitas B Fund	47.11%
Russell Investment Company plc (ix)	
Russell Asia Pacific Fund	33.08%
Russell Sterling Bond Fund	44.26%
Russell Investments US Bond Fund	51.67%
Russell Euro Fixed Income Fund	32.46%
Schroder Matching Plus Bespoke Investment Fund 10 (xxiv)	100.00%
Schroder International Selection Fund (xxiv)	
Multi Asset Total Return	20.71%
Emerging Market Bond Fund	65.36%
ASI UK Equity Index Managed Fund (v)	82.67%
Aberdeen Global Emerging Markets Quantitative Equity Fund (v)	62.10%
Aberdeen European Property Share Fund (v)	32.06%
Aberdeen Sterling Bond Fund (v)	78.65%
Aberdeen Global Corporate Bond Tracker Fund (v)	98.30%
UBS Global Optimal Fund (x)	30.94%
Pan European Urban Retail Fund (xiv)	22.00%
Pemberton European Mid-Market Debt Fund II (xxvi)	100.00%
AgFe UK Real Estate Senior Debt Fund LP (xix)	78.00%

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

16. Investment in subsidiaries (continued)

Principle Place of Business:

(i) Trinity Road, Halifax, West Yorkshire, HX1 2RG
(ii) 69 Morrison Street, Edinburgh EH3 8BW
(iii) 106, Route D'arlon, L-8210 Mamer, Grand Duchy Of Luxembourg
(iv) 35a, Avenue John F. Kennedy, L-1855 Luxembourg, Grand Duchy Of Luxembourg
(v) 1 Bread Street, Bow Bells House, London EC4M 9HH
(vi) 160 Queen Victoria Street, London EC4V 4LA
(vii) 70 Sir John Rogerson's Quay, Dublin 2, Ireland
(viii) Perpetual Park, Perpetual Park Drive, Henley-On-Thames, Oxfordshire RG9 1HH
(ix) 78 Sir John Rogerson's Quay, Dublin 2, Ireland
(x) 21 Lombard Street, London, EC3V 9AH
(xi) 11-15 Seaton Place, St Helier, Jersey, Channel Islands, JE4 0QH
(xii) Exchange Building, St. John's Street, Chichester, West Sussex PO19 1UP
(xiii) 25 Gresham Street, London, EC2V 7HN
(xiv) Jackson House, 18 Saville Row, London, W1S 3PW
(xv) 20 Churchill Place, Canary Wharf, London E14 5HJ
(xvi) 12 Throgmorton Avenue, London EC2N 2DL
(xvii) 79 Sir John Rogerson's Quay, Dublin 2, Ireland
(xviii) 2, Boulevard Konrad Adenauer, L-1115 Luxembourg
(xix) 3rd Floor South, 55 Baker Street, London, W1U 8EW
(xx) 2a, Rue Albert Borschette, BP 2174, L-1021 Luxembourg
(xxi) 1 Greenside Row, Edinburgh EH1 3AN
(xxii) 50 Stratton Street, London W1J 8LL
(xxiii) 57 St James's Street, London SW1A 1LD
(xxiv) 5, Rue Höhenhof, L-1736, Senningerberg, Luxembourg
(xxv) Georges Court, 54-62 Townsend Street, Dublin 2, D02 R156
(xxvi) 2 - 4, Rue Eugène Ruppert L-2453 Luxembourg

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

17. Investment properties

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
At 1 January	3,523	132	3,745	184
Additions – new properties	52	—	8	—
Additions – subsequent expenditure on existing properties	17	—	52	1
Transfers (to) fellow Group company	—	—	—	—
Disposals	(80)	—	(173)	(47)
Net loss from change in fair values	(188)	(12)	(109)	(6)
At 31 December	3,324	120	3,523	132

Rental income arising from investment properties during the year, included in investment income, amounted to: Group £191 million (2019: £191 million) and Company £9 million (2019: £10 million). The total future minimum rental payments receivable under non-cancellable leases, including subleases, are as follows:

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Within one year	167	8	164	7
Between one and two years	151	8	148	7
Between two and three years	137	8	137	7
Between three and four years	127	8	123	7
Between four and five years	112	8	114	7
Beyond five years	946	146	941	137
Total	1,640	186	1,627	172

Direct operating expenses (included within operating expenses) arising in respect of such investment properties during the year amounted to: Group £34 million (2019: £32 million) and Company £1 million (2019: £1 million).

Expenditure on investment properties which did not generate rental income was: Group £1 million (2019: nil) and Company nil (2019: nil). The carrying value of land held for development in Group is £40 million (2019: £36 million) and Company is nil (2019: nil). The carrying value of investment property under development in Group is £27 million (2019: £125 million) and Company is nil (2019: nil).

Due to the nature of the above assets, there is no fixed term associated with these investments. The investment properties are independently valued by Cushman Wakefield, Savills, or Knight Frank, on at least a quarterly basis for the purpose of determining the open market value of the properties.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

18. Assets arising from reinsurance contracts held

Assets arising from reinsurance contracts held can be analysed between those classified as insurance contracts under IFRS 4 and those classified as financial assets at fair value through profit or loss under IFRS 9 (non-participating investment contracts) as follows:

Group	2020 Classified as			2019 Classified as		
	Reinsurance contracts £m	Fair value through profit or loss £m	Total £m	Reinsurance contracts £m	Fair value through profit or loss £m	Total £m
At 1 January	720	22,837	23,557	728	7,132	7,860
Movement recognised through the statement of comprehensive income	90	1,333	1,423	(8)	1,917	1,909
Acquisition of business (note 42)	—	—	—	—	13,616	13,616
Other movements recognised directly through the balance sheet	—	(4,621)	(4,621)	—	172	172
At 31 December	810	19,549	20,359	720	22,837	23,557
Amounts in respect of liabilities arising from insurance and participating investment contracts	810	5,279	6,089	720	8,089	8,809
Amounts in respect of liabilities arising from non-participating investment contracts	—	14,270	14,270	—	14,748	14,748
Total	810	19,549	20,359	720	22,837	23,557

Company	2020 Classified as			2019 Classified as		
	Reinsurance contracts £m	Fair value through profit or loss £m	Total £m	Reinsurance contracts £m	Fair value through profit or loss £m	Total £m
At 1 January	726	22,837	23,563	728	7,132	7,860
Movement recognised through the statement of comprehensive income	93	1,333	1,426	(2)	1,917	1,915
Transfers in	—	—	—	—	13,616	13,616
Other movements recognised directly through the balance sheet	—	(4,621)	(4,621)	—	172	172
At 31 December	819	19,549	20,368	726	22,837	23,563
Amounts in respect of liabilities arising from insurance and participating investment contracts	819	5,279	6,098	726	8,089	8,815
Amounts in respect of liabilities arising from non-participating investment contracts	—	14,270	14,270	—	14,748	14,748
Total	819	19,549	20,368	726	22,837	23,563

Assets arising from reinsurance contracts held include £18,727 million for Group and Company (2019: £22,052 million for Group and Company) that is expected to be settled more than one-year after the reporting date.

During the prior year, the Group and Company acquired assets arising from reinsurance contracts held at fair value through profit or loss under the Zurich Part VII Transfer Scheme (see note 42), which are shown as acquisition of business in the tables above.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

19. Other assets

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Prepayments	56	30	55	28
Other receivables	69	69	65	67
Total	125	99	120	95

20. Derivative financial instruments

In the normal course of business, the Group and Company enter into swap contracts, option contracts, index futures contracts and forward foreign exchange contracts. All such contracts are undertaken either for efficient portfolio management purposes or for the purpose of matching contractual liabilities. In addition, the Company has entered into a swap for the specific purpose of hedging movements in the fair value of certain subordinated debt, as described in note 30.

Swap contracts include currency, interest and inflation rate swaps. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. An interest or inflation rate swap is an agreement between two parties to exchange fixed and variable rate interest payments, based upon interest or inflation rates defined in the contract, without the exchange of the underlying principal amount.

Option contracts include index and single equity options. Such options represent a contract sold by one party to another party offering the right, but not the obligation, to buy or sell a financial asset at an agreed price on a specified future date or within a specified period of time.

Index futures contracts are used to hedge the investment portfolio against adverse movements in underlying markets or effecting policy switches between markets without the need to trade the underlying securities. Futures may also be used for the purposes of efficient portfolio management provided that their substance would otherwise be permitted as a series of direct transactions. Forward foreign exchange contracts are an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate.

Details regarding derivative financial instruments are given in the following tables:

Group	2020			2019		
	Contract Amount £m	Fair value assets £m	Fair value liabilities £m	Contract Amount £m	Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	38,331	4,119	(4,208)	37,633	3,124	(3,154)
Option contracts	2,273	553	(311)	2,744	448	(242)
Index futures contracts	6,882	55	(46)	6,388	44	(35)
Forward foreign exchange contracts	9,361	79	(44)	5,438	36	(14)
Derivative financial instruments designated as fair value hedges	1,500	418	—	1,500	316	—
Total	58,347	5,224	(4,609)	53,703	3,968	(3,445)

Company	2020			2019		
	Contract Amount £m	Fair value assets £m	Fair value liabilities £m	Contract Amount £m	Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	36,794	4,073	(4,208)	37,365	3,091	(3,154)
Option contracts	2,192	552	(310)	2,533	448	(241)
Index futures contracts	4,468	38	(40)	4,038	22	(31)
Forward foreign exchange contracts	6,878	51	(32)	3,454	17	(8)
Derivative financial instruments designated as fair value hedges	1,500	418	—	1,500	316	—
Total	51,832	5,132	(4,590)	48,890	3,894	(3,434)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

20. Derivative financial instruments (continued)

Derivative financial instrument fair value assets include £5,027 million for Group and £4,979 million for Company (2019: £3,840 million for Group and £3,808 million for Company) that is expected to be recovered more than one-year after the reporting date.

Derivative financial instrument fair value liabilities include £4,480 million for Group and £4,480 million for Company (2019: £3,359 million for Group and £3,359 million for Company) that is expected to be settled more than one-year after the reporting date.

The fair value hedges included in the above tables represent interest rate swaps in respect of the interest payments relating to subordinated debt issued by the Group. These instruments form part of hedge relationships with the subordinated debt issued.

Details of collateral accepted and pledged in respect of derivative financial instruments are given in note 37.

21. Loans and receivables at amortised cost

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Accrued income, dividend and rent	225	4	192	9
Loans to related parties	353	353	357	357
Other amounts due from related parties	22	11	56	40
Amounts receivable from direct insurance business	108	105	96	92
Other	310	142	296	121
Total	1,018	615	997	619

Of the above total, £348 million for Group and Company (2019: £351 million for Group and Company) is expected to be recovered more than one-year after the reporting date. The carrying amount of loans to related parties is a reasonable approximation of fair value.

Within loans and receivables at amortised cost, the largest credit concentration is with Scottish Widows Group Limited of £348 million (2019: Scottish Widows Group Limited of £351 million). Further information in respect of credit risk, including credit concentration risk and collateral held against loans to related parties, is given in note 37.

22. Investments at fair value through profit or loss

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Shares and other variable yield securities	94,957	107,884	93,732	101,603
Debt and other fixed/variable income securities	37,256	16,677	32,366	15,299
Loans and Advances to Customers	9,646	9,095	8,804	8,250
Loans and Advances to Banks	4,693	1,468	2,255	1,203
Deposits with cedants	—	1,509	—	1,507
Total investments at fair value	146,552	136,633	137,157	127,862

Debt securities of £30,268 million for Group and £16,035 million for Company (2019: £30,427 million for Group and £14,684 million for Company) is expected to be recovered more than one-year after the reporting date. Loans and Advances to Customers of £9,435 million for Group and £8,884 million for Company (2019: £8,752 million for Group and £8,199 million for Company) is expected to be recovered more than one-year after the reporting date. Loans and Advances to Banks are short-term in nature. Due to the nature of shares and other variable yield securities there is no fixed term associated with these securities. Included within the Company's shares and other variable yield securities are shares in subsidiary undertakings of £53,635 million (2019: £66,551 million), which are held at fair value through profit or loss.

During 2019, the Company acquired assets totalling £7,350 million under the Zurich Part VII Transfer Scheme (see note 42).

During 2020, the Group acquired illiquid credit assets from, or issued by, parties within Lloyds Banking Group totalling £15 million (2019: £255 million). The Group also originated loans during the year totalling £357 million (2019: £306 million) and committed to lend a further £220 million (2019: £286 million). These credit assets are secured on Social Housing, Infrastructure, Lifetime Mortgages and Commercial Real Estate portfolios. Further details on the credit risk and fair value measurement of these assets can be found in note 37.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

22. Investments at fair value through profit or loss (continued)

All assets acquired from Lloyds Banking Group were acquired at their fair value and further details on the credit risk and fair value measurement of these assets can be found in note 37.

As a result of the reclassification of the European business of the Company to assets and liabilities held for sale there was a reduction in investments at fair value through profit or loss for the Company in 2019. See note 42 for further detail.

Deposits with cedants represents funds withheld for reinsurance premiums due to the Company under the reinsurance agreement with SWE.

Structured entities are consolidated when the Group has control in accordance with the consolidation policy set out in note 1(b).

Of the total Loans and advances to customers above, £5,944 million for Group (2019: £5,356 million) and £5,393 million for Company (2019: £4,803 million) is secured on real estate. Of the Loans and advances to customers above, £6,725 million (2019: £6,739 million) for Group and £6,174 million (2019: £6,185 million) for Company was acquired from a related party. All transactions were completed at arm's length.

Within shares and other variable yield securities are cash funds of £785 million for Group and £769 million for Company (2019: £250 million for Group and £250 million for Company) representing collateral received and reinvested in relation to derivatives contracts and stocklending programmes, further details is given in note 37.

Interests in unconsolidated structured entities

Included within investments at fair value through profit or loss are investments in unconsolidated structured entities for Group of £54,819 million (2019: £37,988 million) arising from investments in collective investment vehicles and limited partnerships.

The collective investment vehicles and limited partnerships are primarily financed by investments from investors in the vehicles. The investments are carried at fair value and the Group’s maximum exposure to loss is equal to the carrying value of the investment.

However, investments in collective investment vehicles and limited partnerships are primarily held to match policyholder liabilities and the majority of the risk from a change in the value of the Group’s investment is matched by a change in policyholder liabilities. At 31 December 2020, the total net assets of unconsolidated collective investment vehicles and limited partnerships in which the Group held a beneficial interest were £2,470 billion (2019: £2,361 billion). During the year the Group has not provided any non-contractual financial or other support to these unconsolidated collective investment vehicles and limited partnerships (2019: none).

The Group sponsors a range of collective investment vehicles and limited partnerships where it acts as the decision maker over the investment activities and markets the funds under one of Lloyds Banking Group’s brands. The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from these sponsored unconsolidated collective investment vehicles and limited partnerships, including those in which the Group held no interest at 31 December 2020 was £49 million (2019: £96 million).

Interests in consolidated structured entities

The Group consolidates a number of structured entities, in accordance with the consolidation policy set out in note 1(b).

In 2015 the Company fully assumed a guarantee granted by SW Funding plc. The guarantee concerns a contractual arrangement with State Street Trustees Limited (SSTL), which acts as the Depositary of a consolidated structured entity, the Scottish Widows Property Authorised Contractual Scheme (SWACS). Under the terms of the contractual arrangement, the Company has indemnified SSTL against all losses suffered or incurred by SSTL arising out of or in relation to the scheme property of the SWACS, which consists of real property and for which SSTL is the legal owner. During the year, no losses have arisen and the Company has made no payment under this contractual arrangement (2019: none).

During the year, the Group has not provided any non-contractual financial support to consolidated structured entities and has no current intention of providing such support (2019: none).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

23. Cash and cash equivalents

Cash and cash equivalents for the purposes of the statement of cash flows include the following:

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Cash at bank	217	95	274	97
Short-term deposits	1	—	2	1
Cash at bank	218	95	276	98
Less: bank overdrafts note 33	(2)	(2)	(3)	—
Total	216	93	273	98

24. Share capital

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Issued and fully paid share capital:				
70,000,000 (2019 70,000,000) ordinary shares of £1 each	70	70	70	70
Total	70	70	70	70

25. Insurance contracts and participating investment contract liabilities

An analysis of the change in liabilities arising from insurance contracts and participating investment contracts and reinsurers' share of insurance and participating investment contract liabilities is as follows:

Group		2020			2019	
	£m	£m	£m	£m	£m	£m
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
At 1 January	110,919	(8,809)	102,110	98,252	(7,456)	90,796
New business	3,803	(99)	3,704	5,721	(45)	5,676
Changes in existing business	(820)	2,856	2,036	5,928	(1,325)	4,603
Assumption changes	2,063	(37)	2,026	1,018	17	1,035
At 31 December	115,965	(6,089)	109,876	110,919	(8,809)	102,110

Company		2020			2019	
	£m	£m	£m	£m	£m	£m
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
At 1 January	110,599	(8,815)	101,784	96,117	(7,456)	88,661
New business	3,807	(99)	3,708	7,256	(45)	7,211
Changes in existing business	(942)	2,855	1,913	6,201	(1,331)	4,870
Assumption changes	2,023	(39)	1,984	1,025	17	1,042
At 31 December	115,487	(6,098)	109,389	110,599	(8,815)	101,784

In the prior year, included in the value of gross new business written for the Company is £1,534 million relating to reinsurance premiums receivable from SWE in relation to inter-group reinsurance arrangements following the transfer of policies from SWL to SWE.

An analysis of the expected maturities of liabilities arising from insurance contracts and participating investment contracts is given in note 37. The portfolio is subject to a number of risks as set out in note 37.

As detailed in note 42, in the prior year, insurance contracts and participating investment contracts were transferred to SWE under the SWE Part VII Transfer Scheme.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

25. Insurance contracts and participating investment contract liabilities (continued)

During the year, the Company entered into a longevity pass-through transaction, which passes longevity risk from a subset of Lloyds Banking Group defined benefit pension schemes through the Company and onto an external reinsurer. The Company has an agency role and accounts for the transaction under IFRS 15, with the agency fee income recognised in note 4. However, the legal structure of the transaction is an insurance contract liability with Lloyds Banking Group pension schemes and a reinsurance contract with an external reinsurer. During 2020, the Group and Company has passed through £480 million of associated premiums and £480 million of associated claims.

26. Unallocated surplus

An analysis of the change in unallocated surplus is as follows:

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
At 1 January	412	412	390	390
Change recognised through the statement of comprehensive income	(73)	(73)	22	22
At 31 December	339	339	412	412

Of the above total, £297 million for Group and Company (2019: £362 million for Group and Company) is expected to be settled more than one-year after the reporting date.

27. Future profits on non-participating business in the With Profits Funds

An analysis of the change in future profits on non-participating business in the Scottish Widows With Profits Fund is as follows:

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
At 1 January	49	49	28	28
Change recognised through the statement of comprehensive income	4	4	21	21
At 31 December	53	53	49	49

£53 million for Group and Company (2019: £49 million for Group and Company) is expected to be recovered more than one-year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

28. Provisions for other liabilities and charges

Group	2020			2019		
	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January	101	40	141	112	147	259
Increase in the year	18	25	43	17	29	46
Amount utilised in the period	(28)	(36)	(64)	(28)	(136)	(164)
At 31 December	91	29	120	101	40	141

Company	2020			2019		
	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January	40	40	80	112	99	211
(Release)/increase in the year	(11)	25	14	—	29	29
Amount utilised in the period	(8)	(36)	(44)	(19)	(88)	(107)
Transfers to fellow Group undertakings	—	—	—	(53)	—	(53)
At 31 December	21	29	50	40	40	80

Of the above total, provisions for other liabilities and charges include £64 million for Group and £15 million for Company (2019: £84 million for Group and £32 million for Company) expected to be settled more than one-year after the reporting date.

Customer claims in relation to insurance business in Germany

The Group continues to receive claims in Germany from customers relating to policies issued by the Company, under its former name of Clerical Medical Investment Group Limited. The total provision made to 31 December 2020 is £674 million (2019: £656 million). Utilisation has increased to £28 million in the year ended 31 December 2020 (2019: £28 million); the remaining unutilised provision as at 31 December 2020 is £91 million (2019: £101 million).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved. Claims received to date represent 12 per cent of the relevant total policy population. Key metrics and sensitivities are highlighted in the table below:

Sensitivities	Actuals to date	Anticipated Future	Sensitivity
Number of claims	18,300	3,300	1,000 = £9m
Average uphold rate per claim	59 %	40 %	10% = £8m
Average redress per upheld claim	£42,000	£17,000	£1,000 = £2m
Administrative expenses	£173m	£20m	1 case = £2,500

The actuals to date include claims that have been received and provided for but not yet resolved. For future claims the anticipated average uphold rate, redress per upheld claim and administrative and legal expenses are consistent with the actual experience seen over the 12 months prior to the reporting date. This recent experience is more favourable compared with previous years due to time barring of more onerous types of claim and because most claims are now settled without recourse to litigation.

The Company has provided a 90 percent indemnity to SWE for future provision increases in respect of customer claims and expenses in relation to insurance business in Germany.

Other provisions

Other provisions include amounts for customer remediation costs, restructuring and third-party contractual compensation. In 2018 this included provisions arising from the termination of the asset management agreements with Aberdeen Standard Investments. The provision was settled in full in the prior year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

28. Provisions for other liabilities and charges (continued)

Contingent liabilities

Tax authorities

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where HMRC adopt a different interpretation and application of tax law which might lead to additional tax. A number of Group companies have an open matter in relation to a claim for Group relief of losses incurred in a former Irish banking subsidiary of Lloyds Banking Group, which ceased trading on 31 December 2010. In the second half of 2013 HMRC informed Lloyds Banking Group that their interpretation of the UK rules, permitting the offset of such losses, denies these claims; if HMRC's position is found to be correct, management estimate that this would result in an increase in the Group's current tax liability of approximately £21.2 million (including interest). Lloyds Banking Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due on the Group.

Outsourcing of long-standing customer administration platform

The outsourcing contract signed with Diligenta on 19 September 2017 provides for certain future payments which are contingent on contractual milestones being achieved. At 31 December 2020, no conditions exist for such payments to be made, and as such these payments continue to be regarded as contingent in nature in continuation of the approach from 2017. A proportion of these costs (£17 million) have been recognised already in insurance contract liabilities. The remainder relating the share of these future payments by investment business, will be expensed as incurred in future periods.

Final Salary Pension Schemes

Historically the Group has provided services to Final Salary Pension schemes and trustees including investment, actuarial, documentation and member administration. A number of claims have been brought against the Company after the expiry of the statutory limitation periods. Given the significant delays that have been experienced in the notification in these claims following the statutory limitation period, the potential number of incidents, the number of schemes they cover, and uncertainties associated with establishing liability, the ultimate cost cannot be determined with certainty. However, on the basis of the current information the Directors consider that any additional costs arising are not likely to have a material impact on the financial position of the Company and the Group.

Other legal actions and regulatory matters

During the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings (including class or Group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the United Kingdom and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to properly assess the situation, and no provisions are held in relation to such matters. However, the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

29. Accruals and deferred income

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Accrued expenses	11	7	9	7
Deferred income	17	12	24	15
Other	3	2	2	2
Total	31	21	35	24

Of the above total, £13 million for Group and £10 million for Company (2019: £18 million for Group and £12 million for Company) is expected to be settled more than one-year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

30. Subordinated debt

The carrying value shown in the balance sheet is as follows:

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Subordinated debt	1,469	1,500	1,476	1,500
Issue costs	(11)	(11)	(13)	(13)
	1,458	1,489	1,463	1,487
Accrued interest on subordinated debt	50	50	50	50
Fair value hedge adjustment	384	384	282	283
Total	1,892	1,923	1,795	1,820

Movements in the carrying value are as follows:

	£m	£m
	Group	Company
At 1 January 2020	1,795	1,820
Changes in fair value	90	102
Other non-cash movements	7	1
Redemption of subordinated debt	—	—
At 31 December 2020	1,892	1,923

£1,500 million of fixed rate subordinated notes were issued by the Company in April 2013, at a discount of £13 million. Redemption is due in 2023 for £850 million of the notes, and in 2043 for the remaining £650 million. Interest is payable on an annual basis at a rate of 5.5 per cent on the former and 7 per cent on the latter. Repayment of the notes is subordinate to the claims of the Company's senior creditors, including all policyholders. The interest rate risk of the notes is managed using a derivative which is accounted for using hedge accounting, as set out in note 1(n).

On 5 November 2019 Clerical Medical Finance plc, a subsidiary of Lloyds Banking Group, exercised its option to redeem £51 million of 7.375 per cent undated Subordinated Guaranteed Bonds, the proceeds of which had been loaned to the Company on a similar interest (7.610 per cent) and repayment terms. The Company settled this loan on the same date as the aforementioned subordinated debt redemption.

The fair values of the subordinated debt of the Group and Company are as follows:

Group	2020		2019	
	£m	£m	£m	£m
	Carrying value	Fair value	Carrying value	Fair value
Dated subordinated debt	1,892	1,767	1,795	1,704
Total	1,892	1,767	1,795	1,704

Company	2020		2019	
	£m	£m	£m	£m
	Carrying value	Fair value	Carrying value	Fair value
Dated subordinated debt	1,923	1,767	1,820	1,704
Total	1,923	1,767	1,820	1,704

The fair value of undated subordinated debt has been calculated using published bid prices at the reporting date. The fair value of dated subordinated debt has been assessed by management with reference to published prices.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

31. Non-participating investment contract liabilities

An analysis of the change in net liabilities arising from non-participating investment contracts is as follows:

Group	2020			2019		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
At 1 January	37,456	(14,748)	22,708	13,855	(404)	13,451
New business	2,114	—	2,114	1,810	—	1,810
Changes in existing business	(1,122)	478	(644)	810	(728)	82
Acquisition of business (note 42)	—	—	—	20,981	(13,616)	7,365
At 31 December	38,448	(14,270)	24,178	37,456	(14,748)	22,708

Company	2020			2019		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
At 1 January	37,455	(14,748)	22,707	13,825	(404)	13,421
New business	2,113	—	2,113	1,810	—	1,810
Changes in existing business	(1,135)	478	(657)	839	(728)	111
Acquisition of business (note 42)	—	—	—	20,981	(13,616)	7,365
At 31 December	38,433	(14,270)	24,163	37,455	(14,748)	22,707

In the prior year, the Group and Company acquired liabilities arising from non-participating investment contracts under the Zurich Part VII Transfer Scheme (see note 42), which are shown as acquisition of business in the tables above.

An analysis of the contractual and expected maturities of liabilities arising from non-participating investment contracts is given in note 37.

32. Other financial liabilities

	2020		2019	
	£m	£m	£m	£m
	Group	Company	Group	Company
Amounts payable in respect of direct insurance business	567	545	527	500
Amounts payable on reinsurance contracts	14	14	11	11
Due to related parties	103	207	233	304
Due to brokers	255	153	72	69
Collateral liability	868	821	616	316
Other	407	232	430	222
Total	2,214	1,972	1,889	1,422

Of the above total, nil for Group and nil for Company (2019: nil for Group and nil for Company) is expected to be settled more than one-year after the reporting date.

The Group and Company has recognised assets and liabilities in relation to cash collateral received and reinvested in relation to derivatives contracts and stock lending programme. The liability is recognised as Collateral Liability within Other financial liabilities and the reinvestment assets as Reverse Repurchase Assets, within Loans and Receivables at Amortised Cost and liquidity funds within Investments at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

33. Borrowings

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Bank overdrafts	2	2	3	—
Total	2	2	3	—

The fair value of the balances set out above is not materially different to the carrying value due to the short-term nature of these balances.

34. Net (increase)/decrease in operating assets and liabilities

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Net (increase)/decrease in operating assets				
Deferred costs	—	(3)	17	12
Investment properties	199	12	206	52
Assets arising from reinsurance contracts held	3,198	3,195	(15,697)	(15,703)
Other Assets	(5)	(4)	(29)	(8)
Financial assets:				
Derivative financial instruments	(1,256)	(1,238)	(811)	(765)
Loans and receivables at amortised cost	(21)	4	1,677	1,577
Investments at fair value through profit or loss	(9,395)	(8,771)	(20,376)	(22,919)
Net increase in operating assets	(7,280)	(6,805)	(35,013)	(37,754)
Net increase/(decrease) in operating liabilities				
Insurance contracts and participating investment contract liabilities	5,046	4,888	12,667	14,482
Future profits on non-participating business in the With Profits Funds	(4)	(4)	(21)	(21)
Unallocated surplus	(73)	(73)	22	22
Provisions for other liabilities and charges	(21)	(30)	(118)	(131)
Accruals and deferred income	(4)	(3)	(2)	3
Financial liabilities:				
Subordinated debt	97	103	26	21
Non-participating investment contract liabilities	992	978	23,601	23,630
Derivative financial instruments	1,164	1,156	726	753
Other financial liabilities	325	550	(442)	(186)
External interest in collective investment vehicles	654	—	(978)	—
Lease liabilities	(15)	—	23	—
Net increase in operating liabilities	8,161	7,565	35,504	38,573
Net decrease in operating assets and liabilities	881	760	491	819

35. Dividends paid

	2020	2019
	£m	£m
Total dividends paid on equity shares	560	300

The Company paid dividends of £560 million in February 2020 (2019: £300 million in February 2019). The dividend paid in the year amounted to £8.00 per share (2019: £4.29 per share).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities

Policyholder liabilities can be analysed into With Profits Fund liabilities and non-participating fund liabilities. In accordance with FRS 103, the liabilities of the With Profits Funds are accounted for using the realistic capital regime of the PRA (realistic liabilities). All non-participating liabilities are accounted for using a traditional prospective actuarial discounted cash flow methodology. In calculating the value of policyholder liabilities for the current year, the increased level of uncertainty from impacts of Covid-19 has been considered, in particular in relation to persistency and mortality assumptions.

(1) Processes used to determine key assumptions in respect of insurance and investment contracts

(a) Liabilities of the With Profits Funds calculated on a realistic basis

The Group and Company has With Profits Funds containing both insurance and participating investment contracts. The main components of the realistic liabilities are: with profits benefit reserves (i.e. the total asset shares for with profits policies); the costs of options and guarantees; and deductions levied against asset shares and the impact of smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions of e.g. mortality, persistency and expenses.

The processes for determining the key assumptions are set out below, and unless otherwise stated, remain unchanged from the prior year:

Investment returns and discount rates

A stochastic economic scenario generator, which uses recognised asset models, provides future asset value and yield scenarios; these determine investment returns for each scenario. The economic scenario generator is calibrated to observable yield curves and option prices where possible. Nominal interest rates are modelled using a standard interest rate model, calibrated to risk-free yields. The risk-free yield is defined as the spot yield derived from the UK swap yield curve less a deduction for credit risk. The liabilities are valued by discounting projected future cash flows using the risk free yield.

Investment volatility

The volatility of future equity returns in excess of nominal interest rates has been calibrated to at-the-money forward options of up to 10 years term on appropriate indices. The indices used are the FTSE-100, the EuroStoxx-50, and the S&P 500. For property, no observable prices exist and so volatility has been derived from analysis of historic data.

Mortality

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are based on recent actual experience, industry tables and projection models, internal research and reinsurance terms.

Persistency

Persistency is a function of both the rate of policy termination and the rate at which policyholders stop paying regular premiums. The assumed levels of these rates are based on a combination of historical experience and management's views on future experience taking into consideration potential changes that may result from guarantees and options becoming more valuable under adverse market conditions.

Maintenance expenses

Allowance is made for the charges applied to the With Profits Funds and these are, for conventional with profits business, governed by the relevant Schemes of Transfer.

Guaranteed annuity option take-up rates

The guaranteed annuity option take-up rates are set with regard to the Company's recent actual experience, increased to reflect future uncertainties where the exercise of options by policyholders might increase liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(1) Processes used to determine key assumptions in respect of insurance and investment contracts (continued)

(b) Liabilities of the non-participating funds

(i) Insurance contracts and participating investment contracts

The liabilities of the Group and Company are determined on the basis of recognised actuarial methods. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting these cash flows back to the valuation date allowing for probabilities of occurrence.

The liabilities will vary with movements in interest rates (this applies in particular to the cost of guaranteed benefits payable in the future) and with movements in the cost of life assurance and annuity benefits for which future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality, costs and credit default. Generally, assumptions used to value the liabilities contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgment and reflects management's views on the inherent level of uncertainty. The assumptions to which the liabilities are most sensitive are the interest rates used to discount the cash flows and the mortality assumptions, particularly those for annuitants.

The key assumptions used in the measurement of the non-participating fund liabilities are:

Interest rates

Discount rates used to value the liabilities for annuity business are set with reference to the risk-adjusted yields on the underlying assets and for non-annuity business with reference to cash yields.

The risk adjustment applied to the yields on credit-risky assets reflects a prudent view of potential default losses. The degree of prudence assumed as part of this adjustment has been reviewed, and is considered sufficient to cover a harsh but plausible scenario for the default losses arising as a result of Covid-19.

Mortality and morbidity

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation.

Despite an unprecedented spike in annuitant mortality rates over 2020, it is expected that current annuitant mortality rates will revert to broadly the previous level. The longer-term impacts of Covid-19 on future annuitant mortality improvements remain unclear, with limited data available to date to support any change to our assumptions. The annuitant mortality assumptions disclosed therefore do not include any allowance for Covid-19. Improvements in annuitant mortality are assumed to follow the CMI_2019 mortality projection model from the Actuarial profession's Continuous Mortality Investigation, with a long-term rate of improvement of 2.8 per cent per annum for female and 3.0 per cent for males. The initial rates of improvement assumed are higher than from using the core approach. A higher than core smoothing parameter is also used.

Non-annuitant mortality and morbidity rates are expected to be broadly unchanged in the longer term. The longer term impacts of Covid-19 on future non-annuitant mortality and morbidity rates remain unclear, with limited data available to date to support any change to our assumptions. In the short term it is expected that non-annuitant mortality and morbidity rates will rise, leading to increased claims on Life Assurance and Morbidity products. Allowance has been made for short term increases in non-annuitant mortality and morbidity rates by holding a short term provision.

Maintenance expenses

Allowance is explicitly made for future policy costs. Expense loadings are determined by reference to an internal analysis of current and expected future expense levels, plus a margin for adverse deviations. Explicit allowance is made for future expense inflation from the valuation date. No allowance is made for any expected reductions in expense levels that have not occurred at the valuation date.

For business covered by the Diligenta outsourcing contract the impact from this on maintenance costs is allowed for along with a prudent estimate of the associated costs required to deliver the guaranteed financial benefits from the contract. There is no allowance for prudence on contractual costs.

From 1 May 2018, to comply with Ring-Fenced Bank regulations, a mark-up of 4.5 per cent on certain cost recharges from Lloyds banking Group has been included.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(1) Processes used to determine key assumptions in respect of insurance and investment contracts (continued)

(b) Liabilities of the non-participating funds (continued)

(i) Insurance contracts and participating investment contracts (continued)

Persistency rates

Prudent lapse rate assumptions have been used for term assurance business and other business categories. For term assurance business if the projected liability is negative at any point in the projection of a policy a high lapse rate is assumed, otherwise a low lapse rate is assumed. On other business lines the prudent lapse rates are set at a product level by testing whether an increase or a decrease in lapse rates, relative to our central view, leads to higher reserves.

(ii) Non-participating investment contracts

These contracts are unit-linked, and the liability is determined as the value of the units allocated to the contracts.

(2) Key assumptions

(a) With Profits Funds

Assumptions are set for the realistic valuation of the Company's With Profits Funds. In addition, liabilities in respect of non-participating policies in the Scottish Widows With Profits Fund are also accounted for on the regulatory assessment.

(i) Investment returns and discount rates

In the realistic valuation of liabilities in calibrating the economic scenario generator, the risk-free yield curve is defined as the UK swap yield curve less a deduction for credit risk.

The following interest rates are assumed in the regulatory valuation of non-participating policies in the Scottish Widows With Profits Fund:

	Interest rate (net)	
Class of business	**2020**	**2019**
	%	**%**
Annuities in Payment	0.40	1.00
Deferred Annuities	0.20	0.90

(ii) Investment volatility (realistic liabilities only)

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2020, the 10 year equity-implied at-the-money assumption was 19.0 per cent (16.2 per cent as at 31 December 2019). The assumption for property volatility at 31 December 2020 was 12.5 per cent (31 December 2019: 12.7 per cent). The volatility of interest rates has been calibrated to the absolute implied volatility of Swaptions. This is broadly 0.54 per cent as at 31 December 2020 (0.55 per cent at 31 December 2019), based on an average of the at-the-money surface.

(iii) Mortality assumptions

The mortality assumptions for the main classes of business are set with regard to recent Group experience and general industry trends, all of which are adjusted for smoker status and age / sex specific factors. The mortality tables used in the valuation are summarised below.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(2) Key assumptions (continued)

(a) With Profits Funds (continued)

(iii) Mortality assumptions (continued)

With Profits Fund

Proposition	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Annuities					
Purchased Annuities	**Purchased (whole life)**	Scottish Widows	Males	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013	Bespoke tables CMI2018_M_(7.25) 2%_0.6A_2013
			Females	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013	Bespoke tables CMI2018_F_(7.25) 1.8%_0.6A_2013
Pension Annuities	**Self-employed / personal pensions**	Scottish Widows and Clerical Medical	Males	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013	Bespoke tables CMI2018_M_(7.25) 2%_0.6A_2013
			Females	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013	Bespoke tables CMI2018_F_(7.25) 1.8%_0.6A_2013
Other Annuities	**Deferred Annuities**	Scottish Widows and Clerical Medical	Males	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013	Bespoke tables CMI2018_M_(7.25) 2%_0.6A_2013
			Females	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013	Bespoke tables CMI2018_F_(7.25) 1.8%_0.6A_2013
	Other Annuities in payment	Scottish Widows	Males	87% TMCL08 Ultimate CMI2019_M_(7.25) 2%_0.5A_2013	87% TMCL08 Ultimate CMI2018_M_(7.25) 2%_0.6A_2013
			Females	85% TFCL08 Ultimate CMI2019_F_(7.25) 1.8%_0.5A_2013	85% TFCL08 Ultimate CMI2018_F_(7.25) 1.8%_0.6A_2013
Assurances					
Assurances	**Conventional With Profits**	Scottish Widows	Males Smoker Non smoker/ unknown	85% TMSL08 Ultimate 77% TMNL08 Ultimate 77% TMCL08 Ultimate	85% TMSL08 Ultimate 77% TMNL08 Ultimate
			Females Smoker Non smoker Unknown	85% TFSL08 Ultimate 82% TFNL08 Ultimate 84% TFCL08 Ultimate	85% TFSL08 Ultimate 82% TFNL08 Ultimate 84% TFCL08 Ultimate
		Clerical Medical	Males	35% AMC00 Ultimate	35% AMC00 Ultimate
			Females	50% AFC00 Ultimate	50% AFC00 Ultimate
	Unitised Assurances	Scottish Widows	Males	42% TMCL08 Ultimate	42% TMCL08 Ultimate
			Females	66% TFCL08 Ultimate	66% TFCL08 Ultimate
		Clerical Medical	Males	79% AMC00 Ultimate	79% AMC00 Ultimate
			Females	83% AFC00 Ultimate	83% AFC00 Ultimate

With regard to the above and subsequent tables:

The initial rate of improvement and smoothing parameter used are both higher than the core values in CMI_2019. Additionally, for with-profit annuities business, the long-term rate of mortality improvements in the CMI mortality projections model begins to taper linearly to zero from a lower age than the core value in CMI_2019.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(2) Key assumptions (continued)

(a) With Profits Funds (continued)

(iv) Other assumptions

Deferred annuity contracts with a guaranteed-rate annuity option have been valued based upon an assumed rate of take-up of the guaranteed annuity option of 65 per cent per cent for business which is formerly Scottish Widows plc and 85 per cent for business which is formerly Clerical Medical Investment Group Limited, for the realistic assessment (65 per cent for business which is formerly Scottish Widows plc and 85 per cent for business which is formerly Clerical Medical Investment Group Limited at 31 December 2019).

(b) Non-participating funds

The principal assumptions underlying the calculation of each of the business transferred in from Group companies in respect of non-participating fund liabilities are given below.

(i) Investment returns and discount rates

Class of business	Interest rate (net) 2020 %	Interest rate (net) 2019 %
Annuities in payment	0.96	1.71
Conventional life business and non-unit reserves on linked pre-2013 life business	-0.07	0.46
Conventional life business and non-unit reserves on linked post-2013 life business and conventional pensions business and non-unit reserves on other linked pensions business	-0.09	0.57

(ii) Mortality assumptions

The initial rate of improvement and smoothing parameter used are both higher than the core values in CMI 2019.

The mortality assumptions for the main classes of business are as follows:

Proposition Annuities	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Purchased Annuities	**Purchased (whole life)**	Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013
Pension Annuities	**Self-employed / personal pensions**	Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013
	Executive Pensions and Pension Annuities	Scottish Widows Clerical Medical and Halifax Life	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(2) Key assumptions (continued)

(b) Non-participating funds (continued)

(ii) Mortality assumptions (continued)

Proposition	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Annuities					
Other Annuities	**Group Scheme Annuities/ Transferred from LTSB**	Scottish Widows	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013
	Deferred	Scottish Widows	Males	82% TMCL08 Ultimate CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	80% TFCL08 Ultimate CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013
		Clerical Medical and Halifax Life	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013
	Other Annuities in payment	Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013	94% Bespoke tables CMI2018_M_(7.25) 3%_0.6A_2013
			Females	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013	94% Bespoke tables CMI2018_F_(7.25) 2.8%_0.6A_2013

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(2) Key assumptions (continued)

(b) Non-participating funds (continued)

(ii) Mortality assumptions (continued)

Proposition	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Protection					
Whole of Life	**Protection for Life**	Scottish Widows	Males		
			Smoker	80% Bespoke table	85% Bespoke table
			Non smoker	77% Bespoke table	79% Bespoke table
			Females		
			Smoker	87% Bespoke table	88% Bespoke table
			Non smoker	83% Bespoke table	85% Bespoke table
Term Assurance	**Protection for Life**	Scottish Widows	Males		
			Smoker	100% TMSL08 Select	100% TMSL08 Select
			Non smoker	99% TMNL08 Select	99% TMNL08 Select
			Females		
			Smoker	111% TFSL08 Select	106% TFNL08 Select
			Non smoker	88% TFNL08 Select	89% TFNL08 Select
	Assurances	Scottish Widows	Males		
			Smoker	110% TMSL08 Ultimate	110% TMSL08 Ultimate
			Non smoker/ unknown	95% TMNL08 Ultimate 95% TMNL08 Ultimate	94% TMNL08 Ultimate
			Females		
			Smoker	99% TFSL08 Ultimate	99% TFSL08 Ultimate
			Non smoker/ unknown	86% TFNL08 Ultimate 86% TFNL08 Ultimate	92% TFNL08 Ultimate
		Clerical Medical	Males	29% TMC00 Ultimate	29% TMC00 Ultimate
			Females	40% TFC00 Ultimate	40% TFC00 Ultimate
		St Andrews Life	Males		
			Smoker	139% TMSL08 Ultimate	139% TMSL08 Ultimate
			Non smoker/ unknown	144% TMNL08 Ultimate	139% TMNL08 Ultimate
			Females		
			Smoker	108% TFSL08 Ultimate	108% TFSL08 Ultimate
			Non smoker/ unknown	112% TFNL08 Ultimate	121% TFNL08 Ultimate

Under the mortality assumptions adopted for personal/ self-employed business a male aged 65 will live on average for 24 years.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(2) Key assumptions (continued)

(b) Non-participating funds (continued)

(ii) Mortality assumptions (continued)

Proposition Pensions	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Pensions	**Unitised Pensions (Solutions, Stakeholder)**	Scottish Widows	Males	77% TMCL08 Ultimate	76% TMCL08 Ultimate
			Females	68% TFCL08 Ultimate	67% TFCL08 Ultimate
	Retirement Account	Scottish Widows	Males	68% TMCL08 Ultimate	68% TMCL08 Ultimate
			Females	64% TFCL08 Ultimate	64% TFCL08 Ultimate
	UL Individual Pensions Regular Premium	Halifax Life	Males	50% AMC00 Ultimate	50% AMC00 Ultimate
			Females	53% AFC00 Ultimate	53% AFC00 Ultimate
	UL Individual Pensions Single Premium	Halifax Life	Male	62% AMC00 Ultimate	62% AMC00 Ultimate
			Female	65% AFC00 Ultimate	65% AFC00 Ultimate
	UL Group Pension	Halifax Life	Males	77% AMC00 Ultimate	77% AMC00 Ultimate
			Females	65% AFC00 Ultimate	65% AFC00 Ultimate
	Black Horse Life Pensions	Scottish Widows	Male		
			Smoker	64% TMSL08 Ultimate	64% TMSL08 Ultimate
			Non smoker	101% TMNL08 Ultimate	101% TMNL08 Ultimate
			Unknown	101% TMNL08 Ultimate	101% TMNL08 Ultimate
			Female		
			Smoker	77% TFSL08 Ultimate	77% TFSL08 Ultimate
			Non smoker	98% TFNL08 Ultimate	98% TFNL08 Ultimate
			Unknown	98% TFNL08 Ultimate	98% TFNL08 Ultimate

Proposition Savings and Investments	Product Type	Heritage	Category	2020 Assumption	2019 Assumption
Savings and Investments	**UL SP Investment Bonds**	St. Andrews Life	Males	55% AMC00 Ultimate	55% AMC00 Ultimate
			Females	80% AFC00 Ultimate	80% AFC00 Ultimate

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

36. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(3) The effect of changes in key assumptions

(a) With Profits Funds

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

(b) Non-participating funds

Changes in certain key assumptions were made during the year with the following impacts on profit after tax:

Variable	Impact on profit after tax			
	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Mortality	83	83	158	158
Expenses	(146)	(123)	167	133
Lapses	(4)	(4)	(62)	(47)
Valuation interest rate	(146)	(134)	(46)	(64)
Inflation	95	86	137	180

(4) Sensitivity analysis (in respect of insurance and participating investment contracts only

(a) With Profits Funds

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

(b) Non-participating funds

The following table demonstrates the effect of changes in key assumptions on profit after tax assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated.

Variable	Change in variable	Impact on profit after tax			
		2020		2019	
		£m	£m	£m	£m
		Group	*Company*	*Group*	*Company*
Annuitant Mortality	5% reduction	(303)	(303)	(262)	(262)
Non-annuitant Mortality	5% reduction	8	8	11	11
Lapses	10% reduction	(41)	(41)	(29)	(29)
Future maintenance expenses and investment expenses	10% reduction	147	112	113	93
Interest rate – change in redemption yield(1)	0.25% reduction	(51)	(52)	(34)	(29)
Interest rate – change in valuation margin(2)	0.25% reduction	(538)	(538)	(468)	(468)

(1) This interest rate sensitivity shows the impact of a 0.25 per cent movement in gilt yields and all of the consequential impacts on key economic assumptions including the investment returns, the valuation rates of interest and values of assets backing the business in question.

(2) This interest rate sensitivity shows, for annuity business, the impact of a change to the valuation rate of interest without a corresponding change to asset yields; this would increase the margin available to cover default and other risks.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management

The Group is a part of Lloyds Banking Group. The principal activity is the undertaking of ordinary long-term insurance and savings business and associated activities in the United Kingdom. The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the Lloyds Banking Group network and direct sales. The Company also reinsures business with insurance entities external to the Group.

This note summarises the risks associated with the activities of the Company and the way in which they are managed.

(a) Governance framework

Lloyds Banking Group has established a Risk function with responsibility for implementing the Lloyds Banking Group risk management framework (with appropriate Insurance focus) within the Group.

The risk management approach aims to ensure effective independent checking or 'oversight' of key decisions by operating a 'three lines of defence' model. The first line of defence is line management, who have direct accountability for risk decisions. The Risk function provides oversight and challenge and is the second line of defence. Internal Audit, the third line of defence, provide independent assurance to the Insurance Audit Committee and the Board that risks are recognised, monitored and managed within acceptable parameters.

This enterprise-wide risk management framework for the identification, assessment, measurement and management of risk covers the full spectrum of risks that the Group and Company are exposed to, with risks categorised according to an approved Lloyds Banking Group risk language. This covers the principal risks faced by the Group, including the exposures to market, insurance underwriting, model risk, credit, capital, liquidity, regulatory and legal, conduct, people, governance and operational risks. The Group assesses the relative costs and concentrations of each type of risk and material issues are escalated to the appropriate Insurance executive committees and onto the Board if required. The performance of the Group, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

Responsibility for setting and managing risk appetite and risk policy resides with the Board. Risks are managed in line with Lloyds Banking Group and Insurance risk policies. The Board has delegated certain risk matters to the Insurance Risk Oversight Committee with operational implementation assigned to the Insurance and Wealth Risk Committee (IWRC).

Policy owners, identified from appropriate areas of Lloyds Banking Group and the Insurance and Wealth Division, are responsible for drafting risk policies, ensuring they remain up-to-date and for facilitating any changes. Policies are subject to at least an annual review. Limits are prescribed within which those responsible for the day-to-day management of each Company within the Group can take decisions. Line management are required to follow prescribed reporting procedures to the bodies responsible for monitoring compliance with policy and controlling the risks.

In response to the contingency planning requirements for Covid-19, daily Risk Surgeries were put in place establishing a control amendment process to support colleagues to continue to serve customers and to maintain the operation of business processes. A key aim of the Risk Surgery and control amendment process is to take reasonable steps to ensure that all changes to current ways of working (including operational home working), operational processes or customer treatment is robustly risk assessed and reviewed by the appropriate risk SMEs across the three lines of defence. The changes implemented helped to manage operational and conduct risks e.g. enhancements to the contribution holiday process to support Longstanding Pension customers during the Covid-19 crisis and Individual Annuities quote guarantee period extension. Following the success of the Risk Surgeries, these will continue beyond Covid-19 and are part of our ongoing governance activity. In addition, through the Group's incident management process, we managed key business continuity factors such as absence levels, productivity, IT stability, strategic change activity, regulatory focus, supplier performance and health and safety measures.

(b) Risk appetite

The Board has approved a risk appetite framework that covers Customer Risk, Strategy and Brand Risk and Financial Risks.

Risk appetite is the amount and type of risk that the Board prefers, accepts or wishes to avoid and is aligned to Group strategy. The risk appetite statements set limits for exposures to the key risks faced by the business.

Risk appetite is reviewed at least annually by the Board. Executive owned Tier 2 and Tier 3 limits sit beneath Board owned risk appetite (Tier 1) and are managed and governed within the Insurance and Wealth Division.

Experience against Risk Appetite is reported monthly (by exception) to each meeting of IWRC and ROC. Copies are also supplied regularly to the Group's regulators as part of the close and continuous relationship. Reporting focuses on ensuring, and demonstrating to the Board, and their delegate the ROC that the Group is run in line with approved risk appetite. Any breaches of risk appetite require clear plans and timescales for resolution.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks

The Group writes a variety of insurance and investment contracts which are subject to a variety of financial risks, as set out below. Contracts can be either single or regular premium and conventional (non-profit), With Profits or unit-linked in nature.

The Group is exposed to a range of financial risks through its financial assets, financial liabilities, assets arising from reinsurance contracts and liabilities arising from insurance and investment contracts. In particular, the key financial risk is that long-term investment proceeds are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of financial risk are market, insurance underwriting, credit, capital and liquidity risk.

The Group manages these risks in a numbers of ways, including risk appetite assessment and monitoring of capital resource requirements. In addition, the Principles and Practices of Financial Management (PPFMs) set out the way in which the With Profits business is managed. The Group also uses financial instruments (including derivatives) as part of its business activities and to reduce its own exposure to market risk and credit risk.

For With Profits business, subject to minimum guarantees, policyholders' benefits are influenced by the smoothed investment returns on assets held in the With Profits Funds. The smoothing cushions policyholders from daily fluctuations in investment markets. This process is managed in accordance with the published PPFMs.

The financial risks arising from providing minimum guaranteed benefits are borne in the With Profits Funds, but the Group bears financial risk in relation to the possibility that in extreme market conditions the With Profits Funds might be unable to bear the full costs of the guarantees. The amount of the guaranteed benefits increases as additional benefits are declared and allocated to policies.

For unit-linked business, policyholders' benefits are closely linked to the investment returns on the underlying funds. In the short-term, profit and equity are therefore largely unaffected by investment returns on assets in internal unit-linked funds as any gains or losses will be largely offset by changes in the corresponding insurance and investment contract liabilities, provided that there is appropriate matching of assets and liabilities within these funds. However, any change in the market value of these funds will have an indirect impact on the Group and Company through the collection of annual management and other fund related charges. As markets rise or fall, the value of these charges rises or falls correspondingly.

For non-participating business, the principal market risk is interest rate risk, which arises because assets and liabilities may exhibit differing changes in market value as a result of changes in interest rates. Asset and liability matching is used to mitigate the impact of changes in interest rates where the difference is material.

Financial assets and financial liabilities are measured on an on-going basis either at fair value or at amortised cost. The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

The timing of the unwind of the deferred tax assets and liabilities is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate.

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in market values. The sensitivity analysis presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

(1) Market risk

Market risk is defined as the risk that our capital or earnings profile is affected by adverse market rates, in particular equity, credit default spreads, interest rates and inflation in Insurance business.

Investment holdings within the Group are diversified across markets and, within markets, across sectors. Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely. For assets held with unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

Market risk policy is dependent on the nature of the funds in question, and can be broadly summarised as follows:

- Assets held in shareholder funds are invested in money-market funds, gilts, loans and investment grade bonds to match regulatory capital requirements. The balance of the shareholder fund assets is managed in line with the policies of Lloyds Banking Group to optimise shareholder risk and return. This includes suitable use of derivatives to minimise shareholder risk
- Unit-linked assets are invested in accordance with the nature of the fund mandates. “Unit matching” is adopted on a significant proportion of unit-linked business, under which sufficient units are created to cover Solvency II technical provisions. An equity hedging programme has also been established in respect of the unit-linked business that is not subject to unit matching
- Conventional non-profit liabilities are 'close matched' as far as possible in relation to currency, nature and duration
- With Profits Funds are managed in line with the published PPFMs. Benchmarks and minimum and maximum holdings in asset classes are specified to allow limited investment management discretion whilst ensuring adequate diversification. Swaps and swaptions provide significant protection to the With Profits Funds from the effects of interest rate falls in respect of the cost of guaranteed annuity rates

Below is an analysis of assets and liabilities at fair value through profit or loss and assets and liabilities for which a fair value is required to be disclosed, according to their fair value hierarchy (as defined in note 1 (d)).

Group As at 31 December 2020

	Fair value hierarchy			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**
Investment properties	—	—	3,324	3,324
Assets arising from reinsurance contracts held at fair value through profit or loss	—	19,549	—	19,549
Shares and other variable yield securities	94,188	164	605	94,957
Debt and other fixed/variable income securities	12,802	24,267	187	37,256
Loans and advances to customers	—	—	9,646	9,646
Loans and advances to banks	—	4,693	—	4,693
Derivative financial assets	56	5,040	128	5,224
Total assets	107,046	53,713	13,890	174,649
Derivative financial liabilities	47	4,562	—	4,609
Liabilities arising from non-participating investment contracts	—	38,448	—	38,448
Subordinated debt	—	1,892	—	1,892
Total liabilities	47	44,902	—	44,949

For all financial instruments held at amortised cost by the Group and Company, carrying value is a reasonable approximation of fair value.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

Company As at 31 December 2020

	Fair value hierarchy			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**
Investment properties	—	—	120	120
Assets arising from reinsurance contracts held at fair value through profit or loss	—	19,549	—	19,549
Shares and other variable yield securities	107,067	152	665	107,884
Debt and other fixed/variable income securities	8,106	7,729	842	16,677
Loans and advances to customers	—	—	9,095	9,095
Loans and advances to banks	—	1,468	—	1,468
Deposits with cedants	—	1,509	—	1,509
Derivative financial assets	39	4,965	128	5,132
Total assets	115,212	35,372	10,850	161,434
Derivative financial liabilities	40	4,550	—	4,590
Liabilities arising from non-participating investment contracts	—	38,433	—	38,433
Subordinated debt	—	1,923	—	1,923
Total liabilities	40	44,906	—	44,946

For all financial instruments held at amortised cost by the Group and Company, carrying value is a reasonable approximation of fair value.

Group As at 31 December 2019

	Fair value hierarchy			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**
Investment properties	—	—	3,523	3,523
Assets arising from reinsurance contracts held at fair value through profit or loss	—	22,837	—	22,837
Shares and other variable yield securities	92,947	—	785	93,732
Debt and other fixed/variable income securities	11,878	20,205	283	32,366
Loans and advances to customers	—	—	8,804	8,804
Loans and advances to banks	—	2,255	—	2,255
Derivative financial assets	45	3,777	146	3,968
Total assets	104,870	49,074	13,541	167,485
Derivative financial liabilities	36	3,409	—	3,445
Liabilities arising from non-participating investment contracts	—	37,456	—	37,456
Subordinated debt	—	1,795	—	1,795
Total liabilities	36	42,660	—	42,696

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

Company As at 31 December 2019

	Fair value hierarchy			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Investment properties	—	—	132	132
Assets arising from reinsurance contracts held at fair value through profit or loss	—	22,837	—	22,837
Shares and other variable yield securities	100,727	28	848	101,603
Debt and other fixed/variable income securities	7,394	6,978	927	15,299
Loans and advances to customers	—	—	8,250	8,250
Loans and advances to banks	—	1,203	—	1,203
Deposits with cedants	—	1,507	—	1,507
Derivative financial assets	22	3,726	146	3,894
Total assets	108,143	36,279	10,303	154,725
Derivative financial liabilities	31	3,403	—	3,434
Liabilities arising from non-participating investment contracts	—	37,455	—	37,455
Subordinated debt	—	1,820	—	1,820
Total liabilities	31	42,678	—	42,709

Assets arising from reinsurance contracts held at fair value through profit and loss are valued using the published price for the funds invested in. Fair values have not been disclosed for participating investment contracts. There is currently no agreed definition of fair valuation for DPFs applied under IFRS and therefore the range of possible fair values of these contracts cannot be measured reliably.

The derivative securities classified as Level 2 above have been valued using a tri-party pricing model as determined by the Pricing Source Agreement between Investment Manager(s) and the Third-Party Administrator (State Street). Further detail on valuation is given in note 1(n).

Assets classified as Level 3 include portfolios of illiquid loans and advances to customers, investments in private debt funds and private equity assets, investment properties, investments in asset-backed securities, derivatives and corporate debt instruments.

Private equity investments are valued using the financial statements of the underlying companies prepared by the general partners, adjusted for known cash flows since valuation and subject to a fair value review to take account of other relevant information. Property investment vehicles are valued based on the net asset value of the relevant Company which incorporates surveyors' valuations of property. Investment property is independently valued as described in note 17. Valuations are based on observable market prices for similar properties. Adjustments are applied, if necessary, for specific characteristics of the property, such as the nature, location, or condition of the specific asset. If such information is not available alternative valuation methods such as discounted cash flow analysis or recent prices in less active markets are used. Where any significant adjustments to observable market prices are required, the property would be classified as Level 3. Whilst such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

Covid-19

The current year has experienced a period of major market turbulence, increased volatility and greater illiquidity whilst risk free interest rates have fallen to near historical lows. The effects of the Covid-19 pandemic, and the related actions of central banks and governments, have had uneven impacts across different assets and notably between industry segments. There has been a sustained recovery in equity prices and corporate credit spreads since the initial market shock, however the worsening credit environment has started to have some effect on corporate bond and loan ratings. The Company's assessment for the range of valuation uncertainty has increased 24 per cent between year ends principally due to greater market illiquidity although all valuation methods and models have remained effective.

The following valuation methods and sensitivity of valuation assumptions are applied to both the Group and the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

Loan assets

Loans classified as Level 3 within debt securities are valued using a discounted cash flow model. The discount rate comprises market observable interest rates, a risk margin that reflect loan credit ratings and calibrated to weighted average life on borrower level using sector bond spread curves for each rating, and an incremental illiquidity premium that is estimated by reference to historical spreads at origination on similar loans where available and established measures of market liquidity. Libor tenor and base rate options are valued by comparing the current tenor with the lowest tenor option (basis swap approach). Prepayment options are valued using a monthly time step binomial lattice approach.

The base valuation of loans is £9.1 billion (2019: £8.2 billion). The unobservable inputs in the valuation model include the credit spread and specifically the illiquidity premium of loans compared to bonds and the spread adjustments due to the specific credit characteristics of the borrower. The impact of current economic conditions on the valuation of the loan portfolio has been taken in to account in the year end valuation. The impact of applying reasonably possible alternative assumptions to the value of these loans would be to decrease the fair value by £575 million (2019: £332 million) or increase it by £454 million (2019: £345 million). The impact of alternative assumptions, mainly related to credit spread and illiquidity premium sensitivities is -6.3 per cent (2019: -4.1 per cent) to base in adverse scenario and +5.0 per cent (2019: +4.2 per cent) to base in the favourable scenario.

Agricultural Loans – Agriculture SPV

A portfolio of agricultural loans is securitised through a Special Purpose Vehicle into a Senior Note (A Note) and a Junior Note (E Note). These notes are classified as Level 3 within debt securities. The underlying agricultural loans are valued using a discounted cash flow approach. The discount rate comprises market observable interest rates, a risk margin that reflect underlying loan credit ratings, a spread to represent the risks associated with the Agricultural sector and an incremental illiquidity premium including additional spread for prepayment uncertainty.

The unobservable input in the valuation model is principally the credit spread including the illiquidity premium of loans compared to mortgages, the spread adjustments relevant to the Agricultural sector and the credit profile of the borrowers and the notes issued from the securitisation.

The base valuation of Agricultural loans is £379 million (2019: £376 million). The impact of applying reasonably possible alternative assumptions to the valuation of the loans and senior note would be to decrease the fair value of the SPV by £21 million (2019: £12 million) or increase it by £13 million (2019: £9 million). Impact of alternative assumptions on credit spread, illiquidity premium and prepayment assumptions is -5.5 per cent (2019: -3.1 per cent) to base in the adverse scenario and +3.5 per cent (2019: +2.3 per cent) to base in the favourable scenario. The capital repayment holiday option is a new option in response to the onset of the Covid-19 pandemic, it did not though have a significant impact on the valuation of Agricultural loans.

Securitised Lifetime Mortgages

A portfolio of historical Lifetime Mortgages is securitised through a Special Purpose Vehicle into a Senior Note (A Note) and a Junior Note (B Note).

The value of the B Note is determined using a discounted cash flow approach with a spread based judging movements in the spread for comparable instruments against the changes in expected performance of the underlying portfolio of mortgages.

The value of the A Note is derived as a balancing item from the value of the underlying portfolio less the value of the B note and expenses. These notes are classified as Level 3 within debt securities due to the unobservable parameters required in the valuation of the Senior Note, B note and in the valuation of the portfolio of mortgages.

These lifetime mortgages are valued using a discounted cash flow approach. Decrements (mortality, voluntary early repayment, entry into long-term care) are used to determine the incidence of cash flows. The discount rate is based on a risk free rate plus a spread with the spread assessed by reference to the market for new Lifetime Mortgages, after adjusting for the relative risks associated with this portfolio of mortgages and those of a notional portfolio of new mortgages. In the assessment of the value of the risks, the No Negative Equity Guarantee for Lifetime Mortgages is valued using a time-dependent Black-Scholes model. The value of NNEG is £14 million (2019: £15 million).

Inputs in the valuation model include the gross interest rate applicable to a notional portfolio of new Lifetime Mortgages, risk free rates, residential property volatilities, property valuation haircuts and settlement lags as well as decrement assumptions on mortality, voluntary early repayment and entry into long-term care.

The base valuation of Securitised Lifetime Mortgages is £176 million. December 2020 Valuation Uncertainty calculations reflects uncertainty in the market rates for comparable notional portfolios as well as decrement assumptions and their impacts on the value of the A Note and B Note. The range of notional portfolio rate assumptions was 3.50 per cent to 4.27 per cent (2019: 3.26 per cent to 4.94 per cent).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

The effect of applying the aforementioned reasonably possible alternative assumptions in line with the ranges disclosed above on the A & B Notes would be to decrease the fair value by £5 million (2019: £6 million) or increase it by £9 million (2019: £12 million). The impact of alternative assumptions on credit spread and illiquidity premium is -2.9 per cent (2019: -3.3 per cent) to base in the adverse scenario and +5 per cent (2019: +6.6 per cent) to base in the favourable scenario.

Originated Lifetime Mortgages

New Lifetime Mortgage Loans have been originated by Lloyds Banking Group Retail since April 2020 on behalf of SWL. The loans are being warehoused with the intention to securitise.

The valuation methodology uses the same principles as that for the securitised mortgages. The mortgages are valued using a discounted cash flow approach. Decrements (mortality, voluntary early repayment, entry into long-term care) are used to determine the incidence of cash flows. The discount rate includes an illiquidity spread by reference to the market for new Lifetime Mortgages, after adjusting for the relative risks associated with this portfolio of mortgages and those of a notional portfolio of new mortgages. The model for originated mortgages utilises a Jarrow-Yildirim model, which is a variant of the Black-Scholes mechanism, and an Economic Scenario generator in determining the No Negative Equity Guarantee. The model also includes additional features and factors that are pertinent to recently originated mortgages as compared those that are more mature.

Inputs to the valuation model include the Notional Portfolio updated monthly, risk free rates, swaption volatilities for the Economic Scenario generator, residential property volatilities, property valuation haircuts, settlement delay as well as decrement assumptions on mortality, voluntary early redemption and entry into long-term care.

The base valuation of Originated Life Time Mortgage is £16 million (2019: nil). December 2020 Valuation Uncertainty calculations principally reflect uncertainty in the market rates for comparable notional portfolios, prepayment scenarios and for the recognition of types of acquisition costs and their corresponding impact on the loan portfolio. The range of Notional Interest Rates as of December 2020 for the Favourable scenario was 2.48 per cent to 3.66 per cent and for the Adverse Scenario was 2.68 per cent to 4.18 per cent compared to Base case range of 2.54 per cent to 3.66 per cent. The effect of applying the aforementioned reasonably possible alternative assumptions in line with the ranges disclosed above on the loans would be to decrease the fair value by £0.7 million or increase it by £0.3 million.

Private Credit Funds

SWL hold investments in two private credit funds that hold portfolios of loans to European medium-sized enterprises where loans are often backed by commercial real estate. The assets are classified as Level 3 and are included within equity securities. The underlying loan values, on which the investment values are based, are assessed by the fund manager on a discounted cash flow approach using spreads determined from the credit quality and illiquidity of the loans as compared to other credit assets. Our valuation uncertainty on these investments is assessed based on the valuation uncertainty characteristics of the underlying illiquid loans.

Private equity base value at £544 million (2019: £614 million). The effect of applying reasonably possible alternative assumptions to the value of these assets would be to decrease the fair value by £19 million (2019: £7 million) or increase it by £3 million (2019: £1 million). For Pemberton European Mid-Market Debt Fund II (E) (Pemberton), the impact of alternative assumptions on credit spread and illiquidity premium is -2.0 per cent (2019: -1.2 per cent) to base in the adverse scenario and 0 per cent (2019: 0 per cent) to base in the favourable. For AgFe UK Real Estate Senior Debt Fund LP (AgFe), an alternative approach is used incorporating alternative assumptions on debt margin for the underlying loans, resulting in a -5.9 per cent (2019: -0.9 per cent) to base in the adverse scenario and +1.9 per cent (2019: +0.5 per cent) to base in favourable scenario.

Derivatives with Unobservable inputs

Derivatives are used to hedge interest rate and inflation risks. Where complex risks arise in other assets or liabilities, these hedging derivatives can be complex and have unobservable inputs such as volatilities, correlations and basis differences to vanilla derivatives. In these cases, the complex derivatives are assessed as level 3.

Favourable and adverse scenarios are determined by stressing unobservable inputs into the valuation models, with reference to the valuations of the instruments they hedge where appropriate, in order to generate a plausible range of fair values that different market participants might apply.

The base valuation of Derivatives is £128 million (2019: £146 million). The effect of applying reasonably possible alternative assumptions to the value of these assets would be to decrease the fair value by £17 million (2019: £26 million) or increase it by £1 million (2019: £1 million). The impact of alternative assumptions is -13.8 per cent (2019: -17.5 per cent to base in the adverse scenario and +1.1 per cent (2019: +0.8 per cent) to base in the favourable scenario.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

The table below shows movements in the assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3 only).

Group

	2020		2019	
	£m	£m	£m	£m
	Assets	*Liabilities*	*Assets*	*Liabilities*
Balance at 1 January	13,541	—	12,532	—
Transfers in	179	—	421	—
Transfers out	(356)	—	(147)	—
Purchases	756	—	1,422	—
Disposals	(534)	—	(984)	—
Net gains recognised within net gains on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	311	—	297	—
Balance at 31 December	13,897	—	13,541	—
Total unrealised gains for the period included in the statement of comprehensive income for assets and liabilities held at 31 December	692	—	245	—

Company

	2020		2019	
	£m	£m	£m	£m
	Assets	*Liabilities*	*Assets*	*Liabilities*
Balance at 1 January	10,303	—	8,932	—
Transfers in	154	—	267	—
Transfers out	(340)	—	—	—
Purchases	676	—	1,355	—
Disposals	(407)	—	(649)	—
Assets held for sale	—	—	—	—
Net gains recognised within net gains on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	464	—	398	—
Balance at 31 December	10,850	—	10,303	—
Total unrealised gains for the period included in the statement of comprehensive income for assets and liabilities held at 31 December	498	—	340	—

Total gains or losses for the period included in the statement of comprehensive income, as well as total gains or losses relating to assets and liabilities held at the reporting date, are presented in the statement of comprehensive income, through net gains/losses on assets and liabilities at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

(i) Equity and property risk

The exposure of the Group's insurance and investment contract business to equity risk relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices other than from interest and foreign exchange fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Group monitors exposure limits both to any one counterparty and any one market.

From 2018, exposure to market risk has been managed by the implementation of unit matching and equity hedging to reduce the sensitivity of future dividend payments to market movements. Unit matching involves more effectively matching unit linked liabilities on a best-estimate view (as defined by Solvency regulations). This best-estimate view incorporates an allowance for expected future income and expenses, which are not fully allowed for under IFRS. As a result, this leads to a mismatch between IFRS statutory assets and liabilities in respect of market movements. For example, in the event of rising markets, a loss would now be recognised in the accounts as a result of this mismatch, which would be offset in the future due to higher income as fees are received.

The effect on the Group of changes in the value of investment property held in respect of investment contract liabilities due to fluctuations in property prices is negligible as any changes will be offset by movements in the corresponding liability.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of equities and properties, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market prices at the reporting date. The equity sensitivity includes the impact of unit matching and equity hedging which leads to a statutory profit, mainly due to the hedge payoff under falling markets.

	Impact on profit after tax and equity for the year	
	2020	2019
	£m	£m
10% (2019: 10%) decrease in equity prices	180	131
10% (2019: 10%) decrease in property prices	(5)	(5)

(ii) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve. Interest rate risk in respect of the Group's insurance and investment contracts arises when there is a mismatch in duration or yield between liabilities and the assets backing those liabilities.

The Group's interest rate risk policy requires that the maturity profile of interest-bearing financial assets is appropriately matched to the guaranteed elements of the financial liabilities.

A fall in market interest rates will result in a lower yield on the assets supporting guaranteed investment returns payable to policyholders. This investment return guarantee risk is managed by matching assets to liabilities as closely as possible. An increase in market interest rates will result in a reduction in the value of assets subject to fixed rates of interest which may result in losses, as a result of an increase in the level of surrenders, the corresponding fixed income securities have to be sold.

The effect of changes in interest rates in respect of financial assets which back insurance contract liabilities is given in note 36. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in market interest rates is negligible as any changes will be offset by movements in the corresponding liability.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of interest-bearing financial assets, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market interest rates at the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

(ii) Interest rate risk (continued)

	Impact on profit after tax and equity for the year	
	2020	2019
	£m	£m
25 basis points (2019: 25 basis points) increase in yield curves	43	28
25 basis points (2019: 25 basis points) decrease in yield curves	(51)	(34)
50 basis points (2019: 50 basis points) increase in yield curves	79	51
50 basis points (2019: 50 basis points) decrease in yield curves	(111)	(75)

Interest Rate Benchmark Reform

For the purposes of determining whether:

- a forecast transaction is highly probable
- hedged future cash flows are expected to occur
- a hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk
- an accounting hedging relationship should be discontinued because of a failure of the retrospective effectiveness test

The Group assumes that the interest rate benchmark on which the hedged risk or the cash flows of the hedged item or hedging instrument are based is not altered by uncertainties resulting from interest rate benchmark reform. In addition, for a fair value hedge of a non-contractually specified benchmark portion of interest rate risk, the Group assesses only at inception of the hedge relationship and not on an ongoing basis that the risk is separately identifiable and hedge effectiveness can be measured.

The Group is exposed to the Sterling LIBOR interest rate benchmarks in respect of a fair value hedge. The value of assets designated in fair value hedges had a notional of nil (2019: nil) at 31 December 2020. The value of liabilities designated in fair value hedges had a notional of £1.5 billion (2019: £1.5 billion) at 31 December 2020.

At 31 December 2020, the notional amount of the hedging instruments in hedging relationships to which these amendments apply was £1.5 billion (2019: £1.5 billion).

The Group is managing the process to transition to alternative benchmark rates as part of Lloyds Banking Group's Group-wide IBOR Transition Programme. This programme has developed an implementation plan for new products and a transition plan for legacy products. The programme also encompasses the associated impacts on systems, processes, accounting and reporting and includes dealing with the impact on hedge accounting relationships of the transition to alternative reference rates.

(iii) Foreign exchange risk

Foreign exchange risk relates to the effects of movements in exchange markets including changes in exchange rates.

The Group's foreign currency exposure is driven by holding financial instruments to hedge changes in future investment management fees resulting from exchange rate movements. These investment management fees are based on charges to policyholder funds invested in overseas equities. The hedges are placed by the Company to reduce foreign exchange exposure in the SWL SII capital position.

Sensitivity analysis for the impact of a 10 per cent depreciation of sterling against foreign currency shows a £(117 million) impact for 2020 on profit after tax and equity (2019: £(131 million)).

With the exception of these holdings, the overall risk to the Group is minimal due to the following:

- The Group's principal transactions are carried out in pounds sterling
- The Group's financial assets are primarily denominated in the same currencies as its insurance and investment contract liabilities; and
- Other than shareholder funds, all non-linked investments of the non-profit funds are in sterling or are currency matched. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in foreign exchange rates is negligible as any changes will be offset by movements in the corresponding liability

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(2) Insurance underwriting risk

Insurance underwriting risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value.

The principal risk the Group faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities.

The nature of the Group's business involves the accepting of insurance underwriting risks which primarily relate to mortality, longevity, morbidity, persistency and expenses. When transacting new business, the Group underwrites policies to ensure an appropriate premium is charged for the risk or that the risk is declined.

The Group principally writes the following types of life insurance contracts:

- Life assurance – where the life of the policyholder is insured against death or permanent disability, usually for pre-determined amounts
- Annuity products – where typically the policyholder is entitled to payments which cease upon death; and
- Morbidity products – where the policyholder is insured against the risk of contracting a defined illness

For contracts where death is the insured risk, the most significant factors that could increase the overall level of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected. The occurrence of a pandemic, such as the one arising from Covid-19 in 2020, is regarded as a potentially significant mortality risk. For contracts where survival is the insured risk, the most significant factor is continued improvement in medical science and social conditions that would increase longevity.

Despite an unprecedented spike in mortality rates over 2020 due to the Covid-19 pandemic, it is expected that current mortality rates will revert to broadly the previous level. The longer-term impacts of Covid-19 on future mortality improvements remain unclear, with limited data available to date to support any change to the assumptions. The mortality assumptions disclosed therefore do not include any allowance for Covid-19. Mortality assumptions are updated annually, reflecting both historic experience and future expectations. Therefore as further information becomes available it will be incorporated in future assumptions.

A provision is held in respect of life assurance and to reflect that fact that a short-term spike in mortality claims is expected. A provision is also held in respect of morbidity products as the reduced availability of medical screening has reduced critical illness claims made in 2020. It is expected that this reduction will be offset in 2021 as delayed claims arise. Increased mortality on annuity contracts reduces the payments made and so no provision is necessary for these.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that significantly reduce the insurance underwriting risk accepted. For participating investment contracts, the participating nature of these contracts results in a significant portion of the insurance underwriting risk being shared with the policyholder.

Insurance underwriting risk is also affected by the policyholders' right to pay reduced or no future premiums, to terminate the contract completely, to exercise a guaranteed annuity option or, for bulk annuity business, for pensioners to exercise options following retirement. As a result, the amount of insurance underwriting risk is also subject to policyholder behaviour. On the assumption that policyholders will make decisions that are in their best interests, overall insurance underwriting risk will generally be aggravated by policyholder behaviour. For example, it is likely that policyholders whose health has deteriorated significantly will be less inclined to terminate contracts insuring death benefits than those policyholders who remain in good health.

The Group has taken account of the expected impact of policyholder behaviour in setting the assumptions used to measure insurance and investment contract liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(2) Insurance underwriting risk (continued)

The principal methods available to the Group to control or mitigate longevity, mortality and morbidity risk are through the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment)
- Demographics to accurately assess mortality risk
- Claims management
- Product design
- Policy wording
- The use of reinsurance and other risk mitigation techniques

Rates of mortality and morbidity are investigated annually based on the Group's recent experience. Future mortality improvement assumptions are set using the latest population data available. In addition, bulk annuity business pricing and valuation assumptions also consider underlying experience of the scheme where available. Where they exist, the reinsurance arrangements of each Company in the Group are reviewed at least annually.

Persistency risk is the risk associated with the ability to retain long-term business and the ability to renew short-term business. The Group aims to reduce its exposure to persistency risk by undertaking various initiatives to promote customer loyalty. These initiatives are aimed both at the point of sale and through direct contact with existing policyholders, for example through annual statement information packs.

Covid-19 has resulted in a significant negative shock to the global economy. This is expected to result in increased levels of redundancies. Consequently, it is expected that there will be reduced premium income for contracts in the Workplace and Savings business as premiums are directly linked to the policyholders' employment. A provision is held in respect of this risk.

Further information on assumptions, changes in assumptions and sensitivities in respect of insurance and participating investment contracts is given in note 36.

(3) Credit risk

The risk that parties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet).

The Group accepts credit risk with a variety of counterparties through invested assets which are primarily used to back annuity business, cash in liquidity funds and bank accounts, derivatives and reinsurance. These are managed through a credit control framework which uses a tiered approach to set credit limits:

- Tier 1: Credit limits are set by the Insurance Board as part of the overall Insurance Risk Appetite
- Tier 2: Insurance Investment Strategy Committee (IISC) assists the IISC Chair to set additional controls, sub limits and guidelines. These operate within the boundaries of the Board's Tier 1 Risk Appetite statements and are designed to assist the business with more efficient utilisation of higher level Board Risk Appetite statements in delivery of Insurance's investment strategy
- Tier 3: Insurance Credit approvers have individual personal delegated authorities from the Insurance Board to approve exposures to individual counterparties. Amounts above these delegated authorities require approval by the Insurance Board

Group exposure limits are set for the maximum single name concentration, industry sector, country of risk and portfolio quality. In addition, each individual counterparty exposure requires a counterparty limit or is within the criteria of an approved sanction matrix.

Group exposures are reported on a monthly basis to the Insurance Shareholder Investment Management Committee (ISIM) and semi-annually to IISC, and other senior committees. Any exceptions to limits must be approved in advance by the relevant authority that owns that limit, and any unapproved excesses notified to that authority as a breach.

A core part of the invested asset portfolio which backs the annuity business is invested in loan assets. These have predominately been purchased from Lloyds Banking Group although the Group has also started originating new business. All loan assets are assessed and monitored using established robust processes and controls.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Reinsurance is primarily used to reduce insurance risk. However, it is also sought for other reasons such as improving profitability, reducing capital requirements and obtaining technical support. In addition, reinsurance is also used to offer policyholders access to third-party funds via Investment Fund Links which we are unable to provide through other means. The Group's reinsurance strategy is to reduce the volatility of profits through the use of reinsurance whilst managing the insurance and credit risk within the constraints of the risk appetite limits.

The Group has reinsurance on all significant lines of business where mortality, morbidity or property risks exceed set retention limits. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. All new material reinsurance treaties are subject to Board approval and reinsurance arrangements are reviewed annually to ensure that the reinsurance strategy is being achieved. Reinsurance for Investment Fund Links is not assessed as a counterparty exposure for the Group since with invested assets matching liabilities, any loss to the Group would only be the result of operational failures of internal controls and as such it is outside of the credit control framework described above.

Shareholder funds are managed in line with the Insurance Credit Risk Policy and the wider Lloyds Banking Group Credit Risk Policy which set out the principles of the credit control framework outlined above.

Credit risk in respect of unit-linked funds and With Profits Funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for those funds.

The tables below analyse financial assets and reinsurance assets subject to credit risk exposure using Standard & Poor's rating or equivalent. For certain classes of assets, internally generated ratings have been used where external ratings are not available. This includes credit assets held in both shareholder and policyholder funds. No account is taken of any collateral held to mitigate the risk.

Group As at 31 December 2020

	Total	AAA	AA	A	BBB or lower	Not rated
	£m	£m	£m	£m	£m	£m
Stage 1 assets						
Cash and cash equivalents	218	1	—	191	26	—
Loans and receivables at amortised cost	775	—	—	341	—	434
Loss allowance	—	—	—	—	—	—
Exposure to credit risk	993	1	—	532	26	434
Simplified approach assets						
Loans and receivables at amortised cost	250	—	—	54	—	196
Loss allowance	(7)	—	—	(3)	—	(4)
Exposure to credit risk	243	—	—	51	—	192
Assets at FVTPL						
Assets arising from reinsurance contracts held classified at fair value through profit and loss	19,549	—	19,230	—	314	5
Debt and other fixed/variable income securities	37,256	2,036	16,831	8,602	9,756	31
Derivative financial instruments	5,224	—	636	4,426	90	72
Loans and advances to customers	9,646	76	266	6,131	2,570	603
Loans and advances to banks	4,693	—	213	4,440	3	37
Other						
Reinsurance contracts	810	—	810	—	—	—
Total	78,414	2,113	37,986	24,182	12,759	1,374

Cash at bank, included with Stage 1 assets, is considered to have low credit risk.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Group As at 31 December 2019

	Total	AAA	AA	A	BBB or lower	Not rated
	£m	£m	£m	£m	£m	£m
Stage 1 assets						
Cash and cash equivalents	276	1	17	204	48	6
Loans and receivables at amortised cost	483	—	—	403	—	80
Loss allowance	—	—	—	—	—	—
Exposure to credit risk	759	1	17	607	48	86
Simplified approach assets						
Loans and receivables at amortised cost	514	—	—	22	—	492
Loss allowance	(5)	—	—	—	—	(5)
Exposure to credit risk	509	—	—	22	—	487
Assets at FVTPL						
Assets arising from reinsurance contracts held classified at fair value through profit and loss	22,837	—	—	22,551	286	—
Debt and other fixed/variable income securities	32,366	2,152	15,026	6,689	8,337	162
Derivative financial instruments	3,968	—	454	3,395	74	45
Loans and advances to customers	8,804	73	1,324	4,439	2,376	592
Loans and advances to banks	2,255	—	18	2,172	58	7
Other						
Reinsurance contracts	720	—	589	131	—	—
Total	72,218	2,226	17,428	40,006	11,179	1,379

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Company As at 31 December 2020

	Total	AAA	AA	A	BBB or lower	Not rated
	£m	£m	£m	£m	£m	£m
Stage 1 assets						
Cash and cash equivalents	95	—	—	69	26	—
Loans and receivables at amortised cost	383	—	—	382	—	1
Loss allowance	—	—	—	—	—	—
Exposure to credit risk	478	—	—	451	26	1
Simplified approach assets						
Loans and receivables at amortised cost	236	—	—	54	—	182
Loss allowance	(4)	—	—	(3)	—	(1)
Exposure to credit risk	232	—	—	51	—	181
Assets at FVTPL						
Assets arising from reinsurance contracts held classified at fair value through profit and loss	19,549	—	19,230	—	314	5
Debt and other fixed/variable income securities	16,677	514	9,741	2,714	3,561	147
Derivative financial instruments	5,132	—	606	4,385	90	51
Loans and advances to customers	9,095	76	266	6,131	2,570	52
Loans and advances to banks	1,468	—	—	1,437	—	31
Deposits with cedants	1,509	—	—	—	—	1,509
Other						
Reinsurance contracts	819	—	819	—	—	—
Total	54,959	590	30,662	15,169	6,561	1,977

Cash at bank, included with Stage 1 assets, is considered to have low credit risk.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Company As at 31 December 2019

	Total	AAA	AA	A	BBB or lower	Not rated
	£m	£m	£m	£m	£m	£m
Stage 1 assets						
Cash and cash equivalents	98	—	—	53	45	—
Loans and receivables at amortised cost	411	—	—	402	—	9
Loss allowance	—	—	—	—	—	—
Exposure to credit risk	509	—	—	455	45	9
Simplified approach assets						
Loans and receivables at amortised cost	208	—	—	22	—	186
Loss allowance	(2)	—	—	—	—	(2)
Exposure to credit risk	206	—	—	22	—	184
Assets at FVTPL						
Assets arising from reinsurance contracts held classified at fair value through profit and loss	22,837	—	—	22,551	286	—
Debt and other fixed/variable income securities	15,299	591	9,065	2,792	2,605	246
Derivative financial instruments	3,894	—	452	3,347	74	21
Loans and advances to customers	8,250	73	1,324	4,439	2,376	38
Loans and advances to banks	1,203	—	—	1,188	15	—
Deposits with cedants	1,507	—	—	—	—	1,507
Transferred to Assets held for sale	—	—	—	—	—	—
Other						
Reinsurance contracts	726	—	595	131	—	—
Total	54,431	664	11,436	34,925	5,401	2,005

Amounts classified as 'not rated' within assets arising from reinsurance contracts held principally relate to amounts due from other Group companies which are not rated by Standard & Poor's or an equivalent rating agency.

Expected credit losses are calculated using three key input parameters: the probability of default (PD) (except for lifetime expected credit losses), the expected loss given default (LGD) and the exposure at default (EAD). The probability of default and expected loss given default are determined using internally generated credit ratings. For lease receivables, the past due information is used to determine the expected loss given default.

Expected credit losses are measured on a collective basis for certain Groups of financial assets, such as control accounts, trade receivables and intercompany receivables, which are considered to be homogenous in terms of their risk of default.

Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss, which includes amounts held to cover unit-linked and With Profits Funds liabilities, is considered to be the balance sheet carrying amount.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Group

	2020		2019	
	Maximum exposure £m	Net exposure £m	Maximum exposure £m	Net exposure £m
Loans and receivables at amortised cost	1,018	1,107	997	997
Investments at fair value through profit or loss:				
Assets arising from reinsurance contracts held classified at fair value through profit and loss	19,549	19,549	22,837	22,837
Debt securities	37,256	37,256	32,366	32,366
Derivative Financial Instruments	5,224	5,224	3,968	3,968
Loans and advances to customers	9,646	9,646	8,804	8,804
Loans and advances to banks	4,693	4,693	2,255	2,255
Reinsurance contracts	810	810	720	720
Cash and cash equivalents	218	218	276	276
At 31 December	78,414	78,503	72,223	72,223

Company

	2020		2019	
	Maximum exposure £m	Net exposure £m	Maximum exposure £m	Net exposure £m
Loans and receivables at amortised cost	615	615	619	619
Investments at fair value through profit or loss:				
Assets arising from reinsurance contracts held classified at fair value through profit and loss	19,549	19,549	22,837	22,837
Debt securities	16,677	16,677	15,299	15,299
Derivative Financial Instruments	5,132	5,132	3,894	3,894
Loans and advances to customers	9,095	9,095	8,250	8,250
Loans and advances to banks	1,468	1,468	1,203	1,203
Deposits with cedants	1,509	1,509	1,507	1,507
Reinsurance contracts	819	819	726	726
Cash and cash equivalents	95	95	98	98
At 31 December	54,959	54,959	54,433	54,433

Covid-19

The Group invests in a non-cyclical and high quality portfolio of assets, and regarding shareholder assets, the majority of these are used to match against long-term annuity liabilities. The bonds, loans and gilts in which the Group invests have an average rating of A and are well diversified. All shareholder assets are subject to continued assessment for the impact of Covid-19. Since 1 January 2020 downgrades to sub-investment grade across loans and bonds were £99 million, with a total of 0.5 per cent of shareholder assets rated sub-investment grade.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(i) Concentration risk

Credit concentration risk

Credit concentration risk relates to the inadequate diversification of credit risk.

Credit risk is managed through the setting and regular review of counterparty credit and concentration limits on asset types which are considered more likely to lead to a concentration of credit risk. For other asset types, such as UK government securities or investments in funds falling under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, no limits are prescribed as the risk of credit concentration is deemed to be immaterial. This policy supports the approach mandated by the PRA for regulatory reporting.

At 31 December 2020 and 31 December 2019, the Group did not have any significant concentration of credit risk with a single counterparty or Group of counterparties where limits applied. With the exception of government bonds and UCITS funds, the largest aggregated counterparty exposure is 0.20 per cent (2019: 0.20 per cent) of the Group's total assets).

	Total
	£m
Trade and other receivables:	
Amounts due from brokers	57
Amounts due from Group undertakings	375
Other receivables	586
Cash and cash equivalents with financial institutions	218
Total	1,236

For other receivables, the largest single counterparty balance is with policyholders, which totals £83 million.

Liquidity concentration risk

Liquidity concentration risk arises where the Group is unable to meet its obligations as they fall due or do so only at an excessive cost, due to over-concentration of investments in particular financial assets or classes of financial asset.

As most of the Group's invested assets are diversified across a range of marketable equity and debt securities in line with the investment options offered to policyholders it is unlikely that a material concentration of liquidity concentration could arise.

This is supplemented by active liquidity management in the Group, to ensure that even under stress conditions the Group has sufficient liquidity as required to meet its obligations. This is delegated by the Board to and monitored through the Insurance and Wealth Asset and Liability Committee (IWALCO), IWRC, ISIM and Banking and Liquidity Operating Committee (BLOC).

(ii) Collateral management

Collateral in respect of derivatives

The requirement for collateralisation of OTC derivatives, including the levels at which collateral is required and the types of asset that are deemed to be acceptable collateral, are set out in a Credit Support Annex (CSA), which forms part of the International Swaps and Derivatives Association (ISDA) agreement between the Company and the counterparty.

The CSA will require collateralisation where any net exposure to a counterparty exceeds the OTC counterparty limit, which must be established in accordance with the Derivatives Risk Policy (DRP). The aggregate uncollateralised exposure to any one counterparty must not exceed limits specified in the DRP. Where derivative counterparties are related, the aggregate net exposure is considered for the purposes of applying these limits.

Acceptable collateral is defined in each instance and must take into account the quality and appropriateness of the proposed collateral as well as being acceptable to the entity receiving the collateral. Collateral may include cash, corporate bonds, supranational debt and government debt.

Assets with the following carrying amounts have been pledged in accordance with the terms of the relevant CSAs entered into in respect of various OTC and other derivative contracts:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(ii) Collateral management (continued)

Collateral in respect of derivatives (continued)

	2020		2019	
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Financial assets:				
Investments at fair value through profit or loss	1,483	1,483	773	773
Cash and cash equivalents	445	425	369	369
Total	1,928	1,908	1,142	1,142

Collateral pledged in form of financial assets, is continued to be recognised in the balance sheet as the Group and Company retains all risks and rewards of the transferred assets. The Group and the Company has the right to recall any collateral pledged provided that this is replaced with alternative acceptable assets. The counterparty has right to repledge or sell the collateral in the absence of default by the Group and Company.

Cash collateral pledged where the counterparty retains the risks and rewards is derecognised from the balance sheet and a corresponding receivable is recognised for its return.

Where the Group and Company receives collateral in form of financial instruments for which the counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral for OTC derivatives but not recognised in the balance sheet amounts to £1,440 million (2019: £1,191 million) by the Group and £1,440 million (2019: £1,191 million) by the Company, all of which is permitted to be sold or repledged in the absence of default. However the policy of the Group and Company is not to repledge assets, and hence no collateral was sold or repledged by the Group or Company during the year or in the prior year. Non-cash collateral received during the year was made up of high quality government Bonds such as UK Gilts and Treasury Bills, with the exception of one asset which was a Corporate bond.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to £868 million (2019: £281 million) and £821 million (2019: £250 million) respectively.

Collateral in respect of Stock Lending

Stock lending activity has discontinued during the year. Until this year and in prior years, the Group and Company lent financial assets held in its portfolio to other institutions. The IISC and its sub-committee Investment Management Operational Review Committee (IMOR) were responsible for setting the parameters of stock lending. Stock lending is permitted in accordance with the Insurance Stock Lending Policy. All stock lending took place on an open/call basis, enabling the loan to be recalled at any time within the standard settlement terms of the market concerned.

The financial assets lent do not qualify for derecognition as the Group and Company retains all risks and rewards of the transferred assets except for the voting rights. The aggregate carrying value of securities on loan by the Group is £1 million (2019: £4,137 million) and by the Company is nil (2019: £573 million).

It is the Group's and Company's practice to obtain collateral in stock lending transactions. The accepted collateral can include cash, equities, certain bonds and money-market instruments. On a daily basis, the fair value of collateral is compared to the fair value of stock on loan. The value of collateral must always exceed the value of stock on loan.

Where the Group and Company receives collateral in form of financial instruments for which counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral but not recognised in the balance sheet amounts to £1 million (2019: £4,059 million) by the Group and nil (2019: £528 million) by the Company. The Group and the Company is not permitted to sell or repledge the collateral in the absence of default.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to nil (2019: £334 million) and nil (2019: £66 million) respectively.

There were no defaults in respect of stock lending during the year ended 31 December 2020 (2019: none) which required a call to be made on collateral.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(ii) Collateral management (continued)

Collateral in respect of Reverse Repurchase Agreement

Reverse Repurchase Agreements were closed during the year. In previous years, the Group and Company entered into Reverse Repurchase Agreements whereby it purchased financial instruments with an agreement to resell them back to the counterparty at an agreed price. These transactions are in effect collateralised loans and are reported accordingly. The cash on loan is recognised as Loans and Receivables. The amount of cash on loan in this regard is nil (2019: £334 million) for the Group and nil (2019: £66 million) for Company.

The financial assets received as collateral were not recognised on the balance sheet as the counterparty retains all risks and rewards. The fair value of financial assets accepted as collateral amounted to is nil (2019: £349 million) for the Group and nil (2019: £69 million) for Company.

Collateral in respect of Bulk Annuity Business

Acceptable collateral is defined in each instance and must take into account the quality and appropriateness of the proposed collateral as well as being acceptable to the entity receiving the collateral. Collateral may include cash, corporate bonds, supranational debt and government debt.

During 2020, the Company purchased Bulk Annuity contracts which provide buy in and buy-out solutions to defined benefit pension schemes. To enter into the transaction some trustees may seek collateral to cover the counterparty default scenario. Collateral pledged in respect of Bulk Annuity business was £1,436 million (2019: £1,471 million) for Group and Company.

(iii) Offsetting

The Group and Company are not offsetting under master netting arrangements. Financial assets and liabilities are offset in the statement of financial position when the Group and/or Company has a legally enforceable right to offset and has the intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

a) Derivatives

The derivative assets and liabilities in the tables below consist of OTC and exchange traded (ET) derivatives. The value of gross/net amounts for derivatives in the table below comprises those that are subject to master netting arrangements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32. As a result no amount has been set off in the balance sheet (2019: nil). Total derivatives presented in the balance sheet are shown in note 20.

The 'financial instruments' amounts in the tables below show the values that can be set off against the relevant derivatives asset and liabilities in the event of default under master netting agreements. In addition, the Group and the Company holds and provides cash and securities collateral in respect of derivative transactions to mitigate credit risks.

In the tables below, the amounts of derivative assets or liabilities presented are offset first by financial instruments that have the right of offset under master netting with any remaining amount reduced by the amount collateral.

b) Repurchase and Reverse Repurchase Arrangements

The Group and the Company participates in repurchase (repo) and reverse repurchase arrangements (reverse repo). The gross/net amount in the table shows the relevant assets that the Group and the Company has transferred to counterparties under these arrangements. Cash and non cash collateral is received by the Group and the Company for securities transferred. Cash collateral may be reinvested by the Group and Company through reverse repo against non cash collateral.

In the tables below, the amounts that are subject to repo and reverse repo are set off against the amount of collateral received according to the relevant legal agreements, showing the potential net amounts.

The actual fair value of collateral may be greater than amounts presented in the tables below in the case of over collateralisation.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(iii) Offsetting (continued)

b) Repurchase and Reverse Repurchase Arrangements (continued)

Group as at 31 December 2020

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
Financial assets						
OTC Derivatives	5,169	—	5,169	(3,233)	(2,225)	(289)
ET Derivatives	55	—	55	(29)	(26)	—
Reverse Repo	—	—	—	—	—	—
Financial liabilities						
OTC Derivatives	(4,562)	—	(4,562)	3,233	1,695	366
ET Derivatives	(46)	—	(46)	29	17	—

Group as at 31 December 2019

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
Financial assets						
OTC Derivatives	3,923	—	3,923	(2,352)	(1,499)	72
ET Derivatives	45	—	45	(7)	(38)	—
Repo	—	—	—	—	—	—
Reverse Repo	334	—	334	—	(349)	(15)
Financial liabilities						
OTC Derivatives	(3,409)	—	(3,409)	2,352	1,018	(39)
ET Derivatives	(36)	—	(36)	7	29	—

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(iii) Offsetting (continued)

b) Repurchase and Reverse Repurchase Arrangements (continued)

Company as at 31 December 2020

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
Financial assets						
OTC Derivatives	5,093	—	5,093	(3,233)	(2,185)	(325)
ET Derivatives	39	—	39	(26)	(13)	—
Reverse Repo	—	—	—	—	—	—
Financial liabilities						
OTC Derivatives	(4,550)	—	(4,550)	3,233	1,689	372
ET Derivatives	(40)	—	(40)	26	14	—

Company as at 31 December 2019

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
Financial assets						
OTC Derivatives	3,872	—	3,872	(2,352)	(1,467)	53
ET Derivatives	22	—	22	(1)	(20)	1
Repo	—	—	—	—	—	—
Reverse Repo	66	—	66	—	(69)	(3)
Financial liabilities						
OTC Derivatives	(3,403)	—	(3,403)	2,352	1,018	(33)
ET Derivatives	(31)	—	(31)	1	30	—

The following sub notes are relevant to the tables on this and the preceding page:

1. The value of net amounts presented in the balance sheet for derivatives comprises those derivatives held by the Group and the Company that are subject to master netting arrangements. Total derivatives presented in the balance sheet are shown in note 20.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

(iii) Offsetting (continued)

b) Repurchase and Reverse Repurchase Arrangements (continued)

2. The Group and the Company enters into derivative transactions with various counterparties which are governed by industry standard master netting agreements. The Group and the Company holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

(4) Capital Risk

Capital risk is defined as the risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group. The risk that:

- the Group, or one of its separately regulated subsidiaries, has insufficient capital to meet its regulatory capital requirements
- the Group has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite
- the Group loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution

The business of several of the companies within the Group is regulated by the PRA and the FCA. The PRA rules, which incorporate all Solvency II requirements, specify the minimum amount of capital that must be held by the regulated companies within the Group in addition to their insurance liabilities. Under the Solvency II rules, each insurance Company within the Group must hold assets in excess of this minimum amount, which is derived from an economic capital assessment undertaken by each regulated Company and the quality of capital held must also satisfy Solvency II tiering rules. This is reviewed on a quarterly basis by the PRA.

The Solvency II minimum required capital must be maintained at all-times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

The Group's objectives when managing capital are:

– to have sufficient capital to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders

– to comply with the insurance capital requirements set out by the PRA in the UK

– when capital is needed, to require an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk associated with the business written; and

– to meet the requirements of the Schemes of Transfer

The capital management strategy is such that the integrated insurance business (comprising Scottish Widows Group Limited (SWG) and its subsidiaries, including the Group) will hold capital in line with the stated risk appetite for the business, which is to be able to withstand a one in ten year stress event without breaching the capital requirements. At SWG level it is intended that all surplus capital above that required to absorb a one in ten year stress event will be distributed to Lloyds Banking Group.

Capital support arrangements are in place for SWUTM and SWAS, which are provided by the Company. These irrevocable guarantees will come into effect on the occurrence of a material operational risk event impacting their respective capital positions. In addition for SWAS only, these arrangements will also come into effect on the occurrence of a material fund default event impacting its capital position. The Company has made these arrangements to provide sufficient capital to meet the regulatory capital adequacy and internal capital surplus requirements of these subsidiaries if such events occur.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity and includes subordinated debt (note 30).

The table below sets out the regulatory capital held (specifically, eligible own funds, allowing for any year-end foreseeable dividend, available to cover the solvency capital requirement) at 31 December in each year for the Company on a Solvency II basis. The current year information is an estimate of the final result:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(4) Capital Risk (continued)

Company

	2020 £m	2019 £m
Regulatory Capital held	7,434	7,724

The solvency position reduced over 2020 due to the impacts of the Covid-19 pandemic, but remains above risk appetite at 31 December 2020. The pandemic may impact credit assets further in 2021 and the Company continues to actively monitor and manage its credit asset portfolio. This portfolio is average ‘A’ rated, well diversified and non-cyclical, with less than 1 per cent invested in sub investment grade or unrated assets.

All minimum regulatory requirements were met during the year.

(5) Liquidity risk

Liquidity risk is defined as the risk that the Group does not have sufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from an insurance liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated.

Liquidity risk has been analysed as arising from payments to policyholders (including those where payment is at the discretion of the policyholder) and non policyholder related activity (such as investment purchases and the payment of shareholder expenses).

In order to measure liquidity risk exposure the Group’s liquidity is assessed in a stress scenario. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Company and Group has sufficient liquidity to meet its obligations and remains within approved risk appetite. Liquidity risk appetite considers two time periods; three month stressed outflows are required to be covered by primary liquid assets; and one-year stressed outflows are required to be covered by primary and secondary liquid assets. Primary liquid assets are gilts or cash, and secondary liquid assets are corporate bonds. The stressed outflows also make allowance for the increased collateral that needs to be posted under derivative contracts in stressed conditions. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Group has sufficient liquidity to meet its obligations and remains within approved risk appetite.

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider Lloyds Banking Group Funding and Liquidity Policy. Liquidity risk in respect of each of the major product areas is primarily mitigated as follows:

Annuity contracts

Assets are held which are specifically chosen to correspond to the expectation of timing of annuity payments. Gilts, corporate bonds, loans and, where required, derivatives are selected to reflect the expected annuity payments as closely as possible and are regularly rebalanced to ensure that this remains the case in future.

With Profits contracts

For With Profits business, a portfolio of assets is held in line with investment mandates which will reflect policyholders’ reasonable expectations.

Liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts, bonds and listed equities.

Non-participating contracts

For unit-linked products, portfolios are invested in accordance with unit fund mandates. Deferral clauses are included in policyholder contracts to give time, when necessary, to realise linked assets without being a forced seller. Redemptions (other than on death, maturity or retirement) of units in certain property-linked funds were deferred between 17 March 2020 and 23 September 2020 due to material uncertainty in the valuation of the underlying assets. However, as at 31 December 2020, only one fund (which invests in an external property fund) remains subject to deferral.

For non-linked products other than annuity contracts, backing investments are mostly held in gilts with minimal liquidity risk. Investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. This is achieved by anticipating policyholder behaviour and sales of underlying assets within funds.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(5) Liquidity risk (continued)

Shareholder funds

For shareholder funds, liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts and bonds.

The following tables indicate the timing of the contractual cash flows arising from the Group and Company's financial liabilities, as required by IFRS 7. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group and Company are obliged to pay. The table includes both interest and principal cash flows.

Liquidity risk in respect of liabilities arising from insurance contracts and participating investment contracts has been analysed based on the expected pattern of maturities as permitted by IFRS 4 rather than by contractual maturity. A maturity analysis of liabilities arising from non-participating investment contracts based on expected contract maturities is also given as it is considered that this analysis provides additional useful information in respect of the liquidity risk relating to contracts written by the Group and Company.

Group As at 31 December 2020			Contractual cash flows				
Liabilities	Carrying amount	No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Liabilities arising from non-participating investment contracts	38,448	—	38,448	—	—	—	—
External interests in collective investment vehicles	12,620	12,620	—	—	—	—	—
Derivatives held for trading	4,609	—	49	81	139	837	3,673
Subordinated debt	1,892	—	—	—	113	1,074	1,420
Borrowings	2	—	2	—	—	—	—
Lease liabilities	8	—	—	—	1	2	77
Other financial liabilities	2,214	229	1,961	15	9	—	—
Total	59,793	12,849	40,460	96	262	1,913	5,170

Group As at 31 December 2019			Contractual cash flows				
Liabilities	Carrying amount	No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Liabilities arising from non-participating investment contracts	37,456	—	37,456	—	—	—	—
External interests in collective investment vehicles	11,966	11,855	—	—	—	—	—
Derivatives held for trading	3,445	—	16	67	110	677	2,872
Subordinated debt	1,795	—	—	—	112	1,128	1,465
Borrowings	3	—	3	—	—	—	—
Lease liabilities	197	—	—	—	2	7	188
Other financial liabilities	1,889	297	1,557	28	7	—	—
Total	56,751	12,152	39,032	95	231	1,812	4,525

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(5) Liquidity risk (continued)

An analysis of the contractual cash flows in respect of insurance and investment contract liabilities by expected contract maturity, on a discounted basis, is shown below:

Group As at 31 December 2020	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
Maturity Analysis for liabilities arising from insurance and investment contracts	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Insurance and participating investment contracts	115,965	866	1,257	3,964	25,702	84,176
Non-participating investment contracts	38,448	469	537	2,363	11,510	23,569

Group As at 31 December 2019	Total	Less than 1 month	1-3 Months	3-12 months	1-5 years	More than 5 years
Maturity Analysis for liabilities arising from insurance and investment contracts	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Insurance and participating investment contracts	110,919	893	1,335	4,020	26,343	78,328
Non-participating investment contracts	37,456	334	360	1,596	8,077	27,089

Company As at 31 December 2020			Contractual cash flows				
	Carrying amount	No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
Liabilities	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowings	2	—	2	—	—	—	—
Liabilities arising from non-participating investment contracts	38,433	—	38,433	—	—	—	—
Derivative financial instruments	4,590	—	40	71	138	837	3,673
Subordinated debt	1,923	—	—	—	92	1,100	1,444
Other financial liabilities	1,972	229	1,743	—	—	—	—
Total	46,920	229	40,218	71	230	1,937	5,117

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(c) Financial risks (continued)

(5) Liquidity risk (continued)

Company As at 31 December 2019		Contractual cash flows					
	Carrying amount	No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
Liabilities	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Liabilities arising from non-participating investment contracts	37,455	—	37,455	—	—	—	—
Derivative financial instruments	3,434	—	10	62	110	677	2,872
Subordinated debt	1,820	—	—	—	92	1,147	1,490
Other financial liabilities	1,422	313	1,109	—	—	—	—
Total	44,131	313	38,574	62	202	1,824	4,362

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

An analysis of liabilities arising from insurance and investment contracts by expected contract maturity, on a discounted basis, is shown below:

Company As at 31 December 2020	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
Maturity Analysis for liabilities arising from insurance contracts and investment contracts	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Insurance and participating investment contracts	115,487	851	1,227	5,329	25,107	82,973
Non-participating investment contracts	38,433	469	536	2,361	11,504	23,563

Company As at 31 December 2019	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
Maturity Analysis for liabilities arising from insurance and investment contracts	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Insurance and participating investment contracts	110,599	882	1,313	5,458	25,903	77,042
Non-participating investment contracts	37,455	334	360	1,593	8,070	27,098

(d) Non-financial risks

The Group faces a variety of non-financial risks through its operations and service provision. The Group manages these risks by following the embedded Risk Management Framework, which uses methodologies and systems consistent with those implemented across the Group. The various stages of the framework are:

Identification

- Risks identified in products, processes, channels, customers and people
- Emerging risks
- Changes to the risk profile through on-going tracking, pricing reviews and monitoring of external factors
- Change Management at project, programme or portfolio level
- Implement Risk and Control Framework and standards, including loss estimation and provisioning

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(d) Non-financial risks (continued)

Measurement

- Evaluate risk exposure vs appetite
- Modelling and stress testing, including Internal Model outputs
- Actual vs expected losses
- Scenario analysis
- Reverse stress testing

Management

- Identify and operate controls
- Perform day-to-day control activities
- Ensure appropriate segregation of duties
- Control assessment and estimation of residual risk
- Controls testing activities including Own Risk and Solvency Assessment (ORSA) review
- Effectiveness reviews

Monitoring

- Performance vs risk appetite
- Internal Model performance monitoring
- Risk metrics on for example products, processes, customer experience, service, retention
- Change portfolio
- Regulatory and external environment
- Quality checking
- Action management

Reporting

- Monthly Executive Risk Reporting presented through the corporate governance structure leads to top down review and challenge evidenced via the Insurance Consolidated Risk Report
- Material Events escalation, including related actions
- ORSA reporting

The primary non-financial risk categories are:

Conduct risk

Conduct risk is defined as the risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

Governance risk

Governance risk is defined as the risk that the Group's organisational infrastructure fails to provide robust oversight of decision-making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

Model risk

The risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application and on-going operation of Models and Ratings systems.

Operational risk

Operational risk is defined as the risk of loss from inadequate or failed internal processes, people and systems or from external events. As operational risk covers such a range of elements, there are secondary risk-types within this area, including:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(d) Non-financial risks (continued)

Operational risk (continued)

– **Change risk**

Change risk is defined as the risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within the Group's risk appetite.

– **Cyber and information security**

The risk of financial loss, disruption or damage to the reputation of Lloyds Banking Group from a malicious attack that impacts the confidentiality and/or integrity of electronic data or the availability of systems. The risk also to the security of information and data.

– **Data management**

The risk that the Group fails to effectively govern, manage and protect its data (or the data shared with Third-Party Suppliers) impacting the Group's agility, accuracy, access and availability of data, ultimately leading to poor customer outcomes, loss of value to the Group and mistrust from regulators.

– **Financial crime**

Financial crime is the risk of acts intended to bribe, corrupt, launder money, fund terrorist activity or circumvent sanctions intended for personal gain or to cause loss to another party, by customers/clients, suppliers, third parties or colleagues.

– **Financial reporting risk**

Financial reporting risk is defined as the risk that the Group suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over business or finance processes impacting financial, prudential regulatory, and tax reporting, failure to manage the associated risks of changes in taxation rates, law, corporate ownership or structure and the failure to disclose timely and appropriate information in accordance with regulatory requirements.

– **Fraud**

The risk of acts of deception or omission intended for personal gain or to cause loss to another party, by customers/clients, third parties or colleagues,

– **Internal service provision**

The risk associated with the management of internal service arrangements.

– **IT systems**

The risk of failure in technology governance and the development, delivery and maintenance of effective IT solutions.

– **Operational resilience risk**

Operational resilience risk covers the risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process, technical) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets stakeholder expectations and needs when the continuity of operations is compromised.

– **Physical security risk**

The risk to the security of people and property (including damage (malicious or non-malicious) to Lloyds Banking Group branches and buildings managed through Group Property).

– **Sourcing**

Sourcing risk covers the risk associated with the activity related to the agreement and management of services provided by third parties including outsourcing (excludes internal service arrangements).

People risk

People risk is defined as the risk that the Group fails to provide an appropriate colleague and customer-centric culture, supported by robust regard and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

37. Risk management (continued)

(d) Non-financial risks (continued)

Regulatory and legal risk

The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

(e) UK political uncertainties including EU exit

The UK / EU Trade and Cooperation Agreement means a disorderly Brexit has been avoided. While the TCA contains limited, high-level provisions on financial services, further detail is expected to emerge during this year, and the Group will continue to monitor developments closely. In advance of the UK leaving the EU, a European subsidiary (SWE) was created to ensure continuity of certain insurance business for EEA customers. As a result of Brexit, some customers' bank accounts have had to be closed, meaning these customers will need to set up alternative payment arrangements to continue other Group products and services, including savings, investments and insurance cover. Measures have been put in place to support affected customers, although to date customer responses remain low. The Group continues to monitor the wider post-Brexit environment, including for market volatility. Scenario planning exercises are performed as part of business as usual, while contingency plans have been recalibrated and are regularly reviewed for potential strategic, operational and reputational impacts.

(f) Economic Risk

UK economic growth is muted due to impacts from the Covid-19 pandemic and political uncertainty. High levels of credit market liquidity have reduced spreads and weakened terms in some sectors, creating a potential under-pricing of risk and heightened risk of a market correction. The Group's response is:

- The Group has a robust through the cycle credit risk appetite, including individual limit guidelines, specific sector appetite statements and policies, and affordability and indebtedness controls at origination. In addition to on-going focused monitoring, we conduct portfolio deep dives and larger exposure reviews. We have enhanced our use of early warning indicators including sector specific indicators
- Capital and liquidity are reviewed regularly through committees, ensuring compliance with risk appetite and regulatory requirements
- Internal contingency plans recalibrated and regularly reviewed for potential strategic, operational and reputational impacts
- Wide array of risks considered in setting strategic plans

Additionally, the Covid-19 outbreak and related global health issues are impacting economies and markets. More detail is given in respect of market risk (note 37 (c) (1)), insurance underwriting risk (note 37 (c) (2)), credit risk (note 37 (c) (3)) and capital risk (note 37 (c) (4)).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

38. Related party transactions

(a) Ultimate parent and shareholding

The Group's immediate parent undertaking is Scottish Widows Group Limited, a Company registered in the United Kingdom. Scottish Widows Group Limited has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements.

The ultimate parent undertaking and controlling party is Lloyds Banking Group which is the parent undertaking of the only group to consolidate these financial statements. Once approved, copies of the consolidated Annual Report and Accounts of Lloyds Banking Group may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

(b) Transactions with other Lloyds Banking Group companies

In accordance with IAS 24 'Related Party Disclosures', transactions and balances between Group companies have been eliminated on consolidation and have not been reported as part of the consolidated financial statements.

The Group has entered into transactions with related parties in the normal course of business during the year.

	2020			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Relationship				
Parent	14	(560)	—	348
Other related parties	403	(848)	(1,671)	2,762

	2019			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Relationship				
Parent	15	(300)	—	351
Other related parties	335	(822)	(1,831)	2,275

The Company has entered into transactions with related parties in the normal course of business during the year. Holdings by the Group, including consolidated OEIC investments, give rise to £219 million (2019: £574 million) of shares in the ultimate parent undertaking on the balance sheet, with associated transactions of £(90) million (2019: £(30) million) during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

38. Related party transactions (continued)

(b) Transactions with other Lloyds Banking Group companies (continued)

	2020			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Relationship				
Parent	14	(560)	—	348
Subsidiary	352	(233)	(1,679)	675
Other related parties	386	(713)	(1,651)	2,650

	2019			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Relationship				
Parent	15	(300)	—	351
Subsidiary	1,588	(88)	(1,612)	662
Other related parties	335	(743)	(1,826)	2,175

Further, amounts relating to other related parties of £2,234 million due from OEICs investments were outstanding at 31 December 2020 (2019: £3,418 million). The above balances are unsecured in nature and are expected to be settled in cash.

Included within the consolidated statement of comprehensive income were net (expense)/income amounts related to other parties of £(9) million (2019: £330 million) from OEIC investments.

Parent undertaking transactions relate to all reported transactions and balances with Scottish Widows Group Limited, the Group's immediate parent. Such transactions with the parent Company are primarily financing (through capital and subordinated debt), provision of loans and payment of dividends.

Transactions with other related parties (which includes Subsidiary and Other categories above) are primarily in relation to operating and employee expenses.

(c) Transactions between the Group and entity employing key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are all Directors and Insurance and Wealth Executive Committee (IWEC) members. Key management personnel, as defined by IAS 24, are employed by a management entity, transactions with this entity are as follows:

Key management compensation:

	2020	2020	2019	2019
	£m	£m	£m	£m
	Group	*Company*	*Group*	*Company*
Short-term employee benefits	5	5	7	7
Share-based payments	1	1	2	2
Total	6	6	9	9

Included in short-term employee benefits is the aggregate amount of emoluments paid to or receivable by Directors in respect of qualifying services of £2 million (2019: £3 million).

There were no retirement benefits accruing to Directors (2019: nil) under defined benefit pension schemes. Two Directors (2019: three Directors) are paying into a defined contribution scheme. There were no contributions paid to a pension scheme for qualifying services (2019: nil) for Group and Company.

Certain members of key management in the Group, including the highest paid Director, provide services to other companies within Lloyds Banking Group. In such cases, for the purposes of this note, figures have been included based on an apportionment to the Group of the total compensation earned.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

38. Related party transactions (continued)

(c) Transactions between the Group and entity employing key management (continued)

The aggregate amount of money receivable and the net value of assets received/receivable under share-based incentive schemes in respect of Directors qualifying services was one (2019: £1 million). During the year, two Directors exercised share options (2019: two Directors) and two Directors received qualifying service shares under long-term incentive schemes (2019: three Directors). Movements in share options are as follows:

	2020 £m Options	2019 £m Options
Outstanding at 1 January	15	15
Granted	11	8
Exercised	(4)	(4)
Forfeited	(6)	(4)
Outstanding at 31 December	16	15

Detail regarding the highest paid Director is as follows:

	2020 £m *Group*	2020 £m *Company*	2019 £m *Group*	2019 £m *Company*
Apportioned aggregate emoluments	1	1	2	2
Apportioned share-based payments	—	—	1	1

The highest paid Director did exercise share options during the year. (2019: The highest paid Director did not exercise share options during the year).

39. Lease liabilities

The Group has lease liabilities arising from ground rent commitments on its investment properties. The lease liabilities and related right-of-use assets are included in the balance sheet as follows:

	2020 £m *Group*	2020 £m *Company*	2019 £m *Group*	2019 £m *Company*
Lease liabilities:				
Current	1	—	2	—
Non-current	7	—	21	—
Total	8	—	23	—

Interest expense relating to leases of nil (2019: nil) has been included in finance costs in the statement of comprehensive income. The total cash outflow in respect of leases in the year was nil (2019 £(1) million).

A maturity analysis of lease liabilities is provided in note 37(c) (5) Liquidity Risk.

The total of contingent rents recognised as income during the year was nil (2019: £(2) million). The total of contingent rents recognised as operating expenses during the year was nil (2019: nil). Operating lease receipts and payments represent rental receivable and payable by the Group for certain of its properties. Generally the Group's operating leases are for terms of 15 years or more.

40. Capital commitments

The Group and Company has given an undertaking to provide up to £1,109 million (2019: £1,995 million) of capital to Private Credit Funds and at 31 December 2020, £1,057 million had been drawn down (2019: £1,808 million). The Group has also agreed £220 million of undrawn loan commitments in 2020 (2019: £286 million). £155 million of this undrawn balance is to be drawn within one-year (2019: £199 million) and the remaining £65 million will be drawn within four years (2019: £87 million).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

40. Capital commitments (continued)

The Group has total undrawn lending commitments of £311 million (2019: £353 million). £227 million of this undrawn balance is to be drawn within one-year (2019: £268 million) and the remaining £84 million will be drawn within four years (2019: £85 million). The commitments are irrevocable if the borrowers meet the terms of the agreements.

The Group has contracted for, but not paid for, £38 million (2019: £7 million) of development expenses for investment property. Of this amount, the Company has contracted for, but not paid for, nil (2019: nil).

41. Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2020 and have not been applied in preparing these financial statements. Except as disclosed below, the full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
IFRS 17 'Insurance Contracts'[1]	IFRS 17 replaces IFRS 4 'Insurance Contracts' and is effective for annual periods beginning on or after 1 January 2023, following the Exposure Draft published on 26 June 2019, and the International Accounting Standards Board (IASB) Board meeting on 17 March 2020. IFRS 17 requires insurance contracts and participating investment contracts to be measured on the balance sheet as the total of the fulfilment cash flows and the contractual service margin. Changes to estimates of future cash flows from one reporting date to another are recognised either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it. The effects of some changes in discount rates can either be recognised in profit or loss or in other comprehensive income as an accounting policy choice. The risk adjustment is released to profit and loss as an insurer's risk reduces. These requirements will result in changes to the timing of profit recognition for insurance and participating investment contracts issued by the Group and Company. The Group's IFRS 17 project is progressing to plan. Work has focused on interpreting the requirements of the standard, developing methodologies and accounting policies, and assessing the required changes to reporting and other systems The development of the Group's data warehousing and actuarial liability calculation processes required for IFRS 17 reporting is progressing in line with the Group's plans. The standard will have a significant impact on the accounting for the insurance and participating investment contracts issued by the Group and Company. Presentation and disclosure for these contracts will be considerably different and more extensive than under IFRS 4.	Annual periods beginning on or after 1 January 2023
Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)	The amendments modify specific hedge accounting requirements so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of the uncertainties of the interest rate benchmark reform. These amendments are not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2020
Minor amendments to other accounting standards	The IASB has issued a number of minor amendments to IFRSs effective 1 January 2021 and 1 January 2022 (including IFRS 9 Financial Instruments and IAS 37 Provisions, Contingent Liabilities and Contingent Assets). These amendments are not expected to have a significant impact on the Group.	1 January 2021 and 1 January 2022

[1] At the date of this report, these pronouncements are awaiting endorsement for use in the United Kingdom.

There are no other standards or interpretations that are not yet effective and that would be expected to have a material impact on the Group or Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

42. Acquisitions, discontinued operations and disposals

(a) European business Part VII Transfer Scheme

The Company completed the transfer of the European business from the Company to SWE on 29 March 2019.

The business transferred includes insurance and participating investment contract liabilities. The policies relating to participating investment contracts participate in the CMIG With Profits Fund, and the transferring liability in relation to these policies has been reinsured back to that fund at the point of transfer. The value of assets transferred disclosed does not include any potential future estate distribution or unallocated surplus. Policyholders will retain their rights to participate in the CMIG With Profits Fund, including any share in estate distribution, through the reinsurance agreement.

The value of assets and liabilities transferred on the effective date is shown below. The transfer of the European business had no net impact on profit before tax or equity on the Company and the Group.

Balance sheets (Company)

The assets and liabilities of the European business at the disposal date were as follows:

	29 March 2019 £m
ASSETS	
Investments at fair value through profit or loss	1,864
Cash and cash equivalents	267
Other assets	72
Total Assets	2,203
LIABILITIES	
Insurance contracts and participating investment contract liabilities	2,085
Non-participating investment contract liabilities	29
Provisions for other liabilities	54
Other financial liabilities	35
Total liabilities	2,203

As part of the transfer process SWE issued share capital to the Company sufficient for it to cover its relevant capital requirement and risk margin. The total capital issued by SWE was £71 million (€81 million) and was subscribed for in cash.

(b) Zurich Part VII Transfer Scheme

(i) Summary of acquisition

On 1 July 2019, the Company acquired pensions business from the Zurich Insurance Group. The acquisition is part of an agreement to acquire the UK workplace pensions and savings business from the Zurich Insurance Group. The acquisition will enable the Insurance and Wealth Division to accelerate the development of its financial planning and retirement business and brought around £21 billion of assets under administration to the Insurance and Wealth Division.

Details of the purchase consideration are as follows:

	£m
Amounts previously paid in cash	7
Purchase price adjustment	(5)
Contingent consideration settled during the year	14
Total purchase consideration	16

The purchase price adjustment is in respect of profit earned by Zurich Insurance Group from 3 April 2018 to the date of the Part VII transfer scheme.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

42. Acquisitions, discontinued operations and disposals (continued)

(b) Zurich Part VII Transfer Scheme (continued)

The assets and liabilities recognised as a result of the acquisition in 2019 were as follows:

	£m
Insurance intangible asset (acquired VIF)	6
Investments at fair value through profit or loss	7,350
Other assets	7
Cash and cash equivalents	4
Loans and advances to banks	15
Assets arising from reinsurance contracts held	13,616
Non-participating investment contract liabilities	(20,981)
Other financial liabilities	(11)
Net identifiable assets acquired	6
Add goodwill	10
Net assets acquired	16

The goodwill is attributable to expected future value generated from growth of the business acquired. The goodwill is not tax deductible.

(ii) Acquired receivables

The fair value of acquired trade receivables in 2019 was £7 million. The fair value is equal to carrying value, all of which is expected to be collectible.

(iii) Revenue and profit contribution

The acquired business contributed revenues of £22 million and net profit of £2 million to the Company for the period from 1 July to 31 December 2019.

If the acquisition had occurred on 1 January 2019, total proforma revenue and loss for the Group and Company for the year ended 31 December 2019 would have been £40 million and (£1 million) respectively.

(iv) Net cash outflow of acquisition

Outflow of cash to acquire the pensions business in 2019, net of cash acquired:

	£m
Cash consideration	16
Less balances acquired:	
Cash and cash equivalents	(4)
Net outflow of cash – investing activities	12